Non-negotiable Certificates of Deposit: An Article 9 Problem

Steven L. Harris, Chicago-Kent College of Law

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NON-NEGOTIABLE CERTIFICATES OF DEPOSIT: AN ARTICLE 9 PROBLEM

Steven L. Harris*

INTRODUCTION

Borrowers not uncommonly use a certificate of deposit as security for a personal or commercial loan. Although its precise form may vary with its intended use and the idiosyncracies of its author, a certificate of deposit ("CD") typically contains a bank's (the "issuer's") written acknowledgement of the receipt of a sum of money for deposit and the issuer's promise to pay the sum to a specific person (the "obligee") or to his order. As with any secured transaction, when a certificate of deposit stands as collateral, the lender (secured party) wants to take all steps necessary to ensure that, upon the borrower's (debtor's) default, the collateral will be readily available to satisfy the borrower's debt. Upon default, the secured party most often will assert the debtor's claim against the issuer; that is, the secured party will demand that the issuer honor its obligation by paying the amount stated in the certificate to the secured party. The value of a certificate as collateral may be reduced or even rendered nugatory if another party—e.g., a second secured party, a garnishing creditor of the debtor, or

* Associate Professor of Law, Wayne State University Law School. B.A. 1970, J.D. 1973, The University of Chicago. The author wishes to thank John Dolan, Michael J. McIntyre and Peter Linzer, who read and commented upon a draft of this Article.

1. Unless otherwise indicated, in this Article the term "bank" refers to commercial banks, savings and loan associations, and similar institutions.


3. See U.C.C. § 9-502(1) (secured party may collect debt owing to debtor from debtor's obligor). Alternatively, when a CD matures long after the debtor has defaulted on his debt to the secured party, the secured party may prefer to sell the certificate rather than to collect it. See U.C.C. § 9-504.
the debtor's trustee in bankruptcy—acquires a superior interest in the claim evidenced by the certificate, or if the issuer is free to discharge its obligation by paying the debtor instead of the secured party.\textsuperscript{4}

In contrast to the law governing negotiable certificates,\textsuperscript{5} the law that determines a secured party's rights in a non-negotiable certificate is needlessly uncertain.\textsuperscript{6} Consequently, the costs of secured lending are increased, and the value of a non-negotiable certificate as collateral is diminished. This Article seeks to end this uncertainty by tying the interpretation of the law governing non-negotiable certificates of deposit to the fundamental policies pursued by the Uniform Commercial Code. Part I of this Article places the problem of taking a security interest in a non-negotiable certificate of deposit in context by distinguishing among various types of certificates of deposit and explaining briefly the functions and uses of each. Part II scrutinizes specific provisions of article 9 of the Uniform Commercial Code in light of that article's underlying policies and concludes that article 9 governs the taking of a non-negotiable certificate as original collateral. Part III examines the types of article 9 collateral and concludes that the typical non-negotiable certificate is an article 9 "instrument."\textsuperscript{7}


\textsuperscript{5} \textit{See} notes 31-34 & accompanying text infra. Negotiable certificates are those that conform to U.C.C. § 3-104(1) or § 8-102(1)(a).

\textsuperscript{6} A pair of opinions from the Wyoming Supreme Court reflects this unacceptable uncertainty. In the first opinion, a divided court held that non-negotiable CD's are excluded from article 9 (1962 Official Text) and are subject to the common law. On rehearing, a differently divided court vacated the first opinion and, relying on the 1972 official text, which the Wyoming legislature did not adopt, held that such CD's are subject to article 9. Wightman v. American Nat'l Bank, 591 P.2d 903, 906 (Wyo. 1979), vacated, 610 P.2d 1001, 1004 n.2 (Wyo. 1980). The various forms of non-negotiable CD's are discussed in notes 8-17 & accompanying text infra.

\textsuperscript{7} Although reported opinions have treated the non-negotiable certificate of deposit as an article 9 instrument, they have failed to analyze adequately the issues involved. Some have assumed, without discussion, that a non-negotiable CD is subject to article 9 and is an "instrument." \textit{See, e.g.}, Continental Bankers Life Ins. Co. v. Bank of Alamo, 578 S.W.2d 625, 630 (Tenn. 1979). Others have argued illogically
I. TYPES OF CERTIFICATES OF DEPOSIT

The law distinguishes among various types of certificates on the basis of their form and the manner in which people use them.

A. Savings or Investment Certificate of Deposit

One common type of certificate of deposit is often referred to as a savings or investment certificate. A bank will issue a savings certificate upon receipt of money; the certificate evidences the obligation of the issuer to repay the money, usually with stated interest, upon maturity. Although the deposit creates a debtor-creditor relationship between the issuer and the obligee, from the obligee's viewpoint the transaction resembles a savings or investment transaction rather than a loan to the issuer. Most often the obligee-depositor holds the certificate until maturity, when he either renews it or obtains payment from the issuer.

Certain savings certificates are certificates of deposit as the term is defined in article 3 of the Uniform Commercial Code. "Certificate of deposit" constitutes one of four classes of negotiable instruments subject to article 3 and is defined as "a writing which complies with the requirements of this section [concerning negotiability]" and "is an acknowledgement by a bank of receipt of money with an engagement to repay it." This definition, which is the first definition of "certificate of deposit" in a uniform act, comports with that of a certificate of deposit at common law. In legal theory, then, the article 3 certificate, like its common law

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8. See, e.g., Southview Corp. v. Kleberg First Nat'l Bank, 512 S.W.2d 817, 820 (Tex. Civ. App. 1974). Still others merely assumed that because a security interest in a "certificate of deposit" is subject to article 9, U.C.C. §§ 9-102, 9-104(1), 9-105(1)(e), non-negotiable CD's as well as negotiable CD's are within the scope of the article. Citizens Nat'l Bank v. Borenstein, 374 So. 2d 6, 10 (Fla. 1979); First Nat'l Bank v. Lone Star Life Ins. Co., 524 S.W.2d 525, 528 (Tex. Civ. App.), writ of error refused, 529 S.W.2d 67 (Tex. 1975). A few cases have subjected CD's to article 9 and classified them as instruments without noting whether the certificates in question were negotiable or not. E.g., Stein v. Rand Constr. Co., 400 F. Supp. 944 (S.D.N.Y. 1975); Washington Commercial Bank v. Bollwerk, 582 S.W.2d 695, 700 (Mo. Ct. App. 1979).

9. For convenience, this Article refers to this type of certificate as a "savings certificate."

10. A CD may be payable on demand ("demand CD"), but in the overwhelming majority of cases the issuer's obligation to repay will arise on a future date specified in the certificate ("time CD"). Not all CD's are interest-bearing.

11. U.C.C. § 3-104(2)(c). The other three classes are the draft, check and note. U.C.C. § 3-104(2)(a), (b), (d).

12. See note 2 & accompanying text supra for the common law definition.
predecessor, is a bank's promissory note that contains an acknowledgment that a deposit was received.\textsuperscript{13} From the depositor's perspective, however, the certificate may appear to be essentially a savings account with restrictions on withdrawal of principal.

To be subject to article 3, a certificate of deposit ordinarily must comply with all the requirements of negotiability.\textsuperscript{14} The only explicit statutory exception is a certificate that lacks words of negotiability (i.e., is not payable to order or to bearer) but otherwise complies with section 3-104(1), and whose terms do not preclude transfer. Such a certificate, which pre-Code law referred to as a "non-negotiable instrument,"\textsuperscript{15} is subject to article 3; however, there can be no holder in due course of the certificate.\textsuperscript{16} A certificate that otherwise is not negotiable, e.g., contains a conditional promise to pay, or whose terms prohibit transfer, is not subject to article 3.\textsuperscript{17}

We have identified three kinds of savings certificates: negotiable certificates within article 3, pre-Code "non-negotiable instruments" within article 3, and certificates outside article 3 ("non-article 3 CD's"). As a consequence of the Monetary Control Act

\textsuperscript{13} For the common law theory, see, e.g., People's Bank v. International Fin. Corp., 30 F.2d 46, 49 (4th Cir.), cert. denied, 279 U.S. 858 (1929); Western Cas. & Sur. Co. v. First State Bank, 390 S.W.2d 913, 918 (Mo. Ct. App. 1965); 5B Michie, supra note 10, at 236. The only provision in which the Code treats the certificate of deposit differently from the note, defined at U.C.C. § 3-104(a), is § 3-122(2), which states that a cause of action against the issuer of a demand or time CD accrues only upon demand, rather than automatically on its date or maturity, as is the case with other demand and time instruments, respectively. The comment gives two reasons for this exception. First, "banking custom and expectation is that demand will be made before any liability is incurred by the bank." U.C.C. § 3-122(2) official comment 1. Second, "such certificates are issued with the understanding that they will be held for a considerable length of time, which in many instances exceeds the period of the statute of limitations." \textit{Id.}

\textsuperscript{14} Any writing to be a negotiable instrument within . . . Article [3] must
(a) be signed by the maker or drawer; and
(b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and
(c) be payable on demand or at a definite time; and
(d) be payable to order or to bearer.
U.C.C. § 3-104(1). These requirements are explained in U.C.C. §§ 3-105 to 3-115, 3-119.

\textsuperscript{15} According to Professor Willier, courts applied aspects of the pre-Code law of negotiable instruments to instruments that were not negotiable for reasons other than the lack of words of negotiability. Thus, in his view, article 3 narrows the category of non-negotiable instruments. Willier, \textit{Nonnegotiable Instruments}, 11 \textit{Syracuse L. Rev.} 12, 25-26 (1959).

\textsuperscript{16} U.C.C. § 3-805 provides for a certificate of this kind as follows: "This Article applies to any instrument whose terms do not preclude transfer and which is otherwise negotiable within this Article but which is not payable to order or to bearer, except that there can be no holder in due course of such an instrument."

\textsuperscript{17} U.C.C. § 3-805 official comment.
of 1980, one can anticipate that the last type will predominate. The Act amends section 19(b) of the Federal Reserve Act by requiring, *inter alia*, that all banks maintain a percentage of their "nonpersonal time deposits" on reserve, and that no institution need maintain reserves calculated on other time deposits. The definition of nonpersonal time deposit in Federal Reserve Regulation D includes "[a] time deposit [including a time CD] that is transferable, issued on or after October 1, 1980, to and held by one or more natural persons. . . . A time deposit is transferable [and thus subject to reserve requirements] unless it contains a specific statement on the . . . form representing the account that it is not transferable." Because funds on reserve cannot be used to generate income, banks can be expected to issue non-transferable certificates.

Notwithstanding the foregoing, the non-transferable certificates that a bank may issue in response to the Monetary Control Act may in fact be transferable under some circumstances. The Act imposes reserve requirements on bank deposits "representing funds deposited to the credit of . . . a depositor who is not a natural person," but imposes no such requirement on deposits credited to natural persons. The purpose of treating all transferable deposits as though they were not held by a natural person is to prevent a bank from avoiding the reserve requirements by issuing its certificates to individuals who would then transfer them to corporations, partnerships, and the like. Accordingly, so long as the transaction is reflected on the books of the issuer, one may transfer a non-transferable certificate. A legend such as "transferable only on the records of the bank" thus is adequate to render a certificate non-transferable and exempt from reserve requirements.

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22. By definition, non-transferable certificates would seem to include only those CD's that are not within the ambit of article 3. *But see* note 26 & accompanying text infra.
24. "The Board of Governors [of the Federal Reserve System] is concerned that if transferability were not prohibited, a secondary market in nonnegotiable certificates of deposit might develop in order to avoid reserve requirements, and that nonreservable personal time deposits would be sold to corporations." Board of Governors of the Federal Reserve System, *Questions and Answers Concerning Regulation D, Reserve Requirements of Depository Institutions*, 17 FED. BANKING L. REP. (CCH) ¶ 19,429 (1980).
25. *Id.*
notwithstanding that the certificate may be sold.\textsuperscript{26} Regulation D stipulates that even a certificate marked “not transferable” and thus not subject to reserve requirements may be pledged as collateral for a loan.\textsuperscript{27} Thus these “non-transferable” certificates are among the certificates that are the subject of this article.

B. \textit{Negotiable CD: A Money Market Instrument}

The savings certificate has been used primarily for small- and moderate-sized investments. In 1961, Chase Manhattan Bank found another use for certificates of deposit. It issued interest-bearing, negotiable certificates of deposit in denominations of $100,000 and up, in an effort to attract available funds of large investors, who theretofore had invested elsewhere in the money market.\textsuperscript{28} Other major banks followed quickly. Many investors viewed a negotiable CD of this kind, representing a short-term obligation of a solvent issuer and bearing interest at a rate competitive with investments of similar duration and risk, as a desirable investment. Almost instantly, a secondary market developed, through which an original investor could negotiate an unmatured CD to a purchaser through a broker, just as he might sell other short-term obligations.\textsuperscript{29} A purchaser in the secondary market does not know his transferor and has no convenient way to ascertain whether the transferor may have acted to give the issuer a defense to payment of the obligation. Nor does a purchaser wish to take a CD subject to a third-party claim arising from the conduct of his transferor. By enabling a good faith purchaser to take free of these claims and defenses, the issuer promotes the marketability, and thus the value, of its certificates. For this reason, banks almost invariably issue large CD's in negotiable form.\textsuperscript{30}

\textsuperscript{26} \textit{Id.} A non-transferable certificate bearing a legend that conditions but does not prohibit transfer arguably is a non-negotiable instrument under U.C.C. § 3-805. \textit{But cf.} Citizen's Nat'l Bank v. Bornstein, 374 So. 2d 6, 7, 13 (Fla. 1979) (certificate “assignable only with the consent of and on the books of” the issuer held to evidence conditional promise to pay and thus to be outside U.C.C. § 3-805).


\textsuperscript{28} The “money market” is a group of financial markets that deal in interest-bearing debts that mature within a short period of time or are callable on demand. J. Culbertson, \textit{Money and Banking} 248 (2d ed. 1977).


\textsuperscript{30} Typically, large CD's are issued in “bearer” or “registered” form as defined
Being negotiable, both the large CD and the negotiable savings certificate are outside the scope of this Article. Nevertheless, it is instructive to note that, in contrast to a non-negotiable certificate, the steps a secured party must take to collect a negotiable certificate without the interposition of claims by the debtor, the issuer, or a person who is not a party to the transaction, are relatively clear. Both article 3 and article 8 provide for negotiable instruments. A secured party who attains the status of holder in due course of a certificate that is negotiable under article 3, or bona fide purchaser of a certificate that is negotiable under article 8, ordinarily need not be concerned that the issuer will pay the debtor, exercise a right of set-off, or pay another claimant. The Code sets forth the requirements for and the consequences of achieving these statuses. An unsuspecting secured party that gives value and in good faith takes possession of either kind of certificate, properly indorsed, pursuant to an agreement that the certificate will stand as collateral for the debtor's obligation to the secured party, ordinarily will attain holder in due course or bona fide purchaser status and prevail over all other claimants.

in U.C.C. § 8-102(1)(d), (e). The large, negotiable CD differs from the 26-week money market time certificate issued by banks. The former are negotiable and readily marketable. Although they may yield higher interest than other time certificates, compare 12 C.F.R. § 217.7(f) (1981) (as amended by 46 Fed. Reg. 62,397 (1981)) with 12 C.F.R. § 217.7(b) (1981) (as amended by 46 Fed. Reg. 62,397 (1981) and corrected by 47 Fed. Reg. 9 (1982)), the 26-week CD's are non-negotiable and not readily marketable and thus are included as savings certificates in this article.

31. Article 8, entitled “Investment Securities,” U.C.C. § 8-101, covers “anything which securities markets . . . are likely to regard as suitable for trading,” U.C.C. § 8-102 official comment, which would seem to include the large, negotiable CD. All article 8 securities that are certificated (represented by an instrument) are negotiable instruments, even if they do not meet the article 3 requirements for negotiability. U.C.C. § 8-105(1). If a security is negotiable under both articles, then article 8 and not article 3 governs. U.C.C. §§ 3-103(1), 8-102(1)(e).

32. See U.C.C. §§ 3-302(3), 8-302(3).

33. (1) A holder in due course is a holder who takes the instrument
(a) for value; and
(b) in good faith; and
(c) without notice that it is overdue or has been dishonored
or of any defense against or claim to it on the part of any person.
U.C.C. § 3-302(1).

(1) A “bona fide purchaser” is a purchaser for value in good faith and without notice of any adverse claim:
(a) who takes delivery of a certified security in bearer form
or in registered form, issued or indorsed to him or in blank; or
(b) to whom a security is transferred under the provisions of
paragraph (c), (d)(i), or (g) of Section 8-313(1) [relating to certificated
securities held by intermediaries and identifiable as belonging to a
specific customer, and temporary automatic perfection of security interests
in a security].
U.C.C. § 8-302(1).

As we are about to see, the necessary steps that a secured party must take to achieve such protection with respect to a non-negotiable savings certificate are not nearly so clear. This lack of clarity is caused by a lack of clarity in article 9.

II. THE APPLICATION OF ARTICLE 9 TO NON-Negotiable Certificates Of Deposit Taken As Original Collateral

Article 9 of the Uniform Commercial Code has an exceedingly broad scope and applies "to any transaction (regardless of its form) which is intended to create a security interest in personal property." Thus, unless it is specifically excluded from the scope of article 9, the grant of a security interest in a non-negotiable certificate of deposit should fall within the article. Arguably, section 9-104(j), which provides that article 9 does not apply "to a transfer of an interest in any deposit account" taken as original collateral, excludes non-negotiable certificates from article 9's application. In article 9, "[d]eposit account means a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit." If the term "certificate of deposit" includes a non-negotiable certificate as well as a negotiable one, then the debt evidenced by a non-negotiable certificate is not a "deposit account" and the grant of a security interest in the certificate of deposit is not excluded from article 9.

Unfortunately, article 9 lacks a definition of the term "certificate of deposit"; article 3 contains the only Code definition. We have seen that for article 3 purposes, a writing ordinarily must

36. U.C.C. § 9-104(f) provides that article 9 does not apply "to a transfer of an interest in any deposit account (subsection (1) of Section 9-105), except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312)."
37. U.C.C. § 9-105(1)(e).
38. U.C.C. § 9-105(3) stipulates that the definitions of "check" and "note" in § 3-104 apply to article 9. No similar reference is made for "certificate of deposit," which was added to article 9 by the 1972 amendments. The omission of a definition appears to be an unintended consequence of the Code's editorial process. See U.C.C. § 4-104(3) (§ 3-104 definition of certificate of deposit applies to article 4; however, the term appears nowhere else in that article). The large, negotiable CD discussed in the text accompanying notes 28-30 supra may fall within article 8 and outside article 3. See U.C.C. § 3-103(1). Nevertheless it may be included as a certificate of deposit under article 9. See U.C.C. § 8-321(3) (security interest in an article 8 security is generally subject to article 9). Accordingly, the definition of certificate of deposit in § 3-104 may be too narrow for article 9 purposes, unless the definition is read to mean that "as used in other Articles . . . 'certificate of deposit' . . . may refer to instruments which are not negotiable within this Article [but are negotiable within some other Article]." U.C.C. § 3-104(3).
meet the requirements of negotiability in section 3-104(1) to be a "certificate of deposit." Section 3-104(3) tells us that in other articles, the term "may refer to instruments which are not negotiable within [article 3] as well as to instruments which are so negotiable," as the context requires. Although at first blush this provision may appear to suggest that every non-negotiable certificate is a certificate of deposit as the term is used in section 9-105(1)(e) (and therefore is included in the scope of article 9), there are two reasons why this suggestion is not necessarily compelling.

First, official comment 6 to section 3-104 states that “[s]ubsection (3) is intended to make clear the same policy expressed in section 3-805”—i.e., that the rules governing negotiable certificates will apply to a non-negotiable certificate whose terms do not prohibit transfer and which would be negotiable but for the absence of words of negotiability. This policy is designed to promote the use of instruments that are governed by the relatively certain rules of article 3 concerning, e.g., the manner and effect of transferring the instrument and the liability of persons signing it, while preserving for the issuer and other parties liable on the instrument those claims and defenses that would not be available against a holder in due course were the instrument negotiable.40 The policy extends, however, only to instruments that would be negotiable but for the absence of words of negotiability and whose terms do not preclude transfer. It does not extend to non-article 3 CD’s, which are not likely to find currency in the marketplace, and as to which, therefore, the rules designed for negotiable instruments are likely to be inapplicable.41 Arguably, then, section 3-104(3) instructs us to include as “certificates of deposit” in article 9 only those non-negotiable instruments described in section 3-805.42

A second reason why section 3-104(3) does not compel the conclusion that every non-negotiable certificate, or even every section 3-805 certificate, is a “certificate of deposit” for article 9 pur-

39. See notes 11-17 & accompanying text supra.
40. The official comment to § 3-805 suggests that although the technical “non-negotiable instrument” is not negotiable, it is still “a mercantile specialty which differs in many respects from a simple contract” and is treated as such in commercial and banking practices. U.C.C. § 3-805 official comment.
42. These include pre-Code “non-negotiable instruments.” See notes 15-16 & accompanying text supra. One may argue that the policy of U.C.C. § 3-805 extends to certificates marked “non-negotiable," but which are transferable nevertheless. See notes 18-27 & accompanying text supra.
poses, is that the section directs us to apply the term "certificate of deposit" to non-negotiable certificates only "as the context may require." This limitation, which instructs us to read the Code so that it makes good commercial sense, is implicit in every definitional section.\textsuperscript{43} In order to determine what the context of article 9 requires, we turn to a consideration of the place of section 9-105(1)(e), the definition of "deposit account," in the scheme of that article.

A. History of Section 9-105(1)(e)

The 1972 amendments to article 9 added section 9-105(1)(e) to the Code.\textsuperscript{44} Previously, the 1962 official text excluded from article 9's coverage a transfer of "any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization."\textsuperscript{45} Although the clear intent of this provision was to exclude from article 9 such accounts when taken as original collateral, the section was drafted so broadly as to suggest that article 9 did not apply even to a bank

\textsuperscript{43} U.C.C. § 1-102 and its comments explicitly impose this limitation on the entire Code. The section provides in relevant part:

\begin{enumerate}
\item This Act shall be liberally construed and applied to promote its underlying purposes and policies.
\item Underlying purposes and policies of this Act are
\begin{enumerate}
\item to simplify, clarify and modernize the law governing commercial transactions;
\item to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
\item to make uniform the law among the various jurisdictions.
\end{enumerate}
\end{enumerate}

\textsuperscript{44} U.C.C. § 1-102(1), (2). Official comment 1 makes it clear that "the proper construction of the [Code] requires that its interpretation and application be limited to its reason." U.C.C. § 1-102 official comment 1. To this effect,

\begin{quote}
[the text of each section should be read in light of the purpose and policy of the rule or principle in question, as [sic] also of the [Code] as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.]
\end{quote}

\textit{Id.}


\textsuperscript{45} U.C.C. § 9-104(k) (1962 Official Text).
account representing the proceeds of the original collateral. Under a broad reading, a lender who took a security interest in the debtor's inventory and its proceeds and who required the debtor to deposit all receipts from the sale of inventory into a separate bank account, would lose its article 9 security interest in the account. The 1962 version of section 9-306(4)(d) indicates that the drafters of the Code did not intend this result. That section specifically provides that under particular circumstances the secured party has a security interest in certain bank accounts containing proceeds.\textsuperscript{46} The courts had little difficulty limiting the 1962 exclusion of deposit accounts in section 9-104 to their use as original collateral; they routinely extended security interests created in other collateral to cover proceeds deposited into bank accounts.\textsuperscript{47} Nevertheless, to eliminate any possible inconsistency between the exclusions in section 9-104 and the proceeds provisions of section 9-306, the Review Committee for article 9 redrafted section 9-104.\textsuperscript{48} The 1972 text makes clear that although it is not properly the subject of a security interest as original collateral, a deposit account is properly the subject of an article 9 security interest when it is the proceeds of original collateral.\textsuperscript{49}

As part of its effort to clarify this point, the Review Committee proposed that the Code sponsors add a new definition of "deposit account" to section 9-105 "to cover all the types of accounts intended to be covered" by the provisions in sections 9-104 and 9-306.\textsuperscript{50} The Review Committee's second preliminary draft contained a definition of deposit account that did not exclude certificates of deposit,\textsuperscript{51} but the Committee's final report did exclude certificates of deposit from that definition.\textsuperscript{52} The Committee gave

\textsuperscript{46} U.C.C. § 9-306(4)(d) (1962 Official Text) provides as follows:

In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest . . . .

(d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is (i) subject to any right of set-off; and (ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period.

\textsuperscript{47} See, e.g., Domain Indus. v. First Security Bank & Trust Co., 230 N.W.2d 165, 167 (Iowa 1975), and cases cited therein.

\textsuperscript{48} Final Report, supra note 44, at 220-21.

\textsuperscript{49} See note 36 supra for the current text of U.C.C. § 9-104(f).

\textsuperscript{50} Final Report, supra note 44, at 221.

\textsuperscript{51} Preliminary Draft No. 2, supra note 44, at 65.

\textsuperscript{52} Final Report, supra note 44, at 38.
no reason for the change. The result is that "certificates of deposit" are subject to article 9, at least under the 1972 version.

Thus we proceed with our consideration of the meaning of "certificate of deposit" in article 9 without the benefit of the Committee's thoughts on the matter. The drafting history is enlightening in one regard, however. The Committee apparently wrote the definition of deposit account with a view toward its effect on the proceeds rules in section 9-306 and not with the section 9-104 exclusions from article 9 foremost in mind. We turn, therefore, to a consideration of the proceeds rules, which appears to be the proper context in which to determine whether non-negotiable certificates of deposit should be subject to article 9.

B. The Proceeds Rules—Section 9-306

Generally, a security interest continues in any identifiable

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53. Several members of the Review Committee, as well as the Reporter, Associate Reporter, and a Consultant, were kind enough to respond to my inquiry about the change. At his own suggestion, Associate Reporter Homer Kripke graciously searched for an explanation through six bound volumes of internal Committee memoranda—all to no avail. Although he and several others shared useful thoughts on the larger issues discussed in this Article, no one was quite sure of the Committee's motivation in changing proposed § 9-103(1)(e).


55. U.C.C. § 9-306(1), (2) and (3) provide that:

(1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are "cash proceeds". All other proceeds are "non-cash proceeds".

(2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured
proceeds, presumably including a non-negotiable certificate. Of course, a secured party is concerned not only that proceeds will be subject to a security interest, but also that the security interest in proceeds be perfected. Section 9-306(3) provides that if the security interest in the original collateral were perfected, then the security interest in the proceeds will be a continuously perfected security interest, whose priority will be the same as that of the original collateral. Thus, if the debtor sells inventory in which the secured party had perfected a security interest, then the latter automatically will have a perfected security interest in a non-negotiable certificate that is received by the debtor in exchange for the inventory. If the security interest in the inventory were perfected on May 1, and the debtor sold the inventory and received the non-negotiable certificate on August 1, then the security interest in the certificate would date, for priority purposes, from May 1.

A security interest thus acquired in proceeds does not remain perfected indefinitely; rather, it automatically becomes unperfected ten days after the debtor receives the proceeds unless

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56. U.C.C. § 9-306(2).
57. An unperfected secured party’s rights are subordinate to those of a perfected secured party, the debtor’s trustee in bankruptcy, and certain transferees from the debtor. U.C.C. § 9-301. See note 204 infra.
58. Accord U.C.C. § 9-312(6): “For the purposes of subsection (5) [regarding conflicting security interests in the same collateral] a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.”
59. The examples in this part of the Article illustrate the operation of the proceeds rules. They are not necessarily typical commercial transactions.
60. The date established for priority purposes will precede the date on which the security interest attaches and becomes enforceable against the debtor. Cf. U.C.C. § 9-203(1)(c) (security interest not enforceable until debtor has rights in collateral). Special priority rules may apply to competing claimants of a non-negotiable certificate received as proceeds. U.C.C. § 9-308.
one of three conditions described in section 9-306(3) is fulfilled.\textsuperscript{61} As we shall see, each condition is likely to provide notice to third parties of the security interest in the proceeds.

1. The Perfect as to Proceeds Rule—Section 9-306(3)(c)

One of these conditions is satisfied when the security interest in the proceeds is perfected before expiration of the ten-day period.\textsuperscript{62} Perfection as to the proceeds themselves will provide the requisite notice to third parties who wish to use the proceeds as original collateral. The method of perfection will, of course, depend on how the proceeds are categorized under article 9.\textsuperscript{63} If a non-negotiable certificate of deposit may serve as original collateral under article 9 (i.e., if a non-negotiable certificate is not a "deposit account"), then we must determine which category of original collateral would include the certificate in order to learn how to perfect.\textsuperscript{64} For present purposes, it is sufficient to state that a secured party may perfect its security interest in a non-negotiable certificate either by taking possession of it or by filing a financing statement, depending on whether the certificate is categorized as an "instrument" or a "general intangible," respectively.\textsuperscript{65} Regardless of how it is categorized, if a non-negotiable certificate is a deposit account, however, it is not properly the subject of an article 9 security interest as original collateral, and there will be no way to perfect a security interest in it.\textsuperscript{66} In this event, the "perfect as to proceeds rule" of section 9-306(3)(c) will be of no assistance to the secured creditor whose original collateral has been exchanged for a non-negotiable certificate of deposit. The security interest in the certificate will become unperfected after ten days unless one of the other perfection requirements of section 9-306(3) is satisfied.

\textsuperscript{61} For the text of U.C.C. § 9-306(3), see note 55 supra.

\textsuperscript{62} U.C.C. § 9-306(3)(c).

\textsuperscript{63} The perfection steps for original collateral are detailed in U.C.C. § 9-302 and the sections to which it refers. They include filing a financing statement, the secured party's taking possession of the collateral, and noting the secured party's interest on a certificate of title. U.C.C. § 9-302.

\textsuperscript{64} See notes 134-230 & accompanying text infra.

\textsuperscript{65} The terms "instrument" and "general intangible" are defined in note 136 infra.

\textsuperscript{66} This assumes that "perfected" as used in U.C.C. § 9-306(3)(c) refers to perfection under the Code and not to perfection under the common law or other statute. While by no means the only plausible reading, this reading is supported by U.C.C. § 9-303(1), which provides in relevant part that "[a] security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306." U.C.C. § 9-303(1).
2. The File in the Same Office Rule—Section 9-306(3)(a)

A secured party may achieve continuity of perfection beyond the ten-day period if a filed financing statement already covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the same office or offices.67 In this situation perfection in proceeds continues beyond the ten-day period, because any third party who wished to take a security interest in the property received as proceeds and who checked the filings for prior security interests would have had notice of the security interest in the original collateral. Were the third party knowledgeable about section 9-306, he then would have investigated whether the property was in fact the proceeds of the collateral described in the filed financing statement.

In the case of a negotiable savings certificate received as proceeds, this situation will never occur. An article 3 negotiable instrument is an "instrument" under article 9.68 Perfection of a security interest in an article 9 instrument may be made only by the secured party's taking possession of the instrument; filing is wholly ineffective.69 If a non-negotiable certificate likewise is excluded from the definition of deposit account and is classified as an "instrument," then the "file in the same office rule" of section 9-306(3)(a) will not aid a secured party, for the same reason. But if the non-negotiable certificate of deposit is classified as a general intangible, so that the filing of a financing statement is required for perfection, then the situation contemplated by section 9-306(3)(a) may come to pass. Perfection of a security interest in a non-negotiable certificate of deposit received as proceeds will continue beyond the ten-day period in the case where the secured party perfected a security interest in the original collateral by filing and a security interest in a non-negotiable certificate may be perfected by filing in the same office.70 Thus, so long as a non-negotiable certificate is within article 9—regardless of whether it is classified as an instrument or as a general intangible—the file in the same office rule works as it was designed to work. That is, perfection extends beyond the ten-day period only when the secured party has put others on notice of its interest. On the other hand, by including non-negotiable certificates of deposit in the term "deposit account," one necessarily excludes these certificates

68. U.C.C. § 9-105(1)(i).
69. "A security interest in . . . instruments . . . can be perfected only by the secured party's taking possession, except as provided in [U.C.C. §§ 9-304(4) (temporary, automatic perfection upon attachment), 9-304(5) (temporary perfection when instrument delivered to debtor for collection, etc.)] and subsections (2) and (3) of Section 9-306 on proceeds." U.C.C. § 9-304(1).
70. U.C.C. § 9-401 governs the place of filing.
from the operation of this proceeds rule, as was the case with the perfect as to proceeds rule of section 9-306(3)(c).\textsuperscript{71}

3. The Cash Proceeds Exception to the File in the Same Office Rule

An exception to the file in the same office rule arises when the proceeds in question are acquired indirectly with "cash proceeds." If they are so acquired, then the original filing is not deemed to be effective to perfect a security interest in the second-level proceeds unless they are the same type of property as the original collateral.\textsuperscript{72} Some examples will demonstrate how this exception works.

Assume that the debtor exchanges inventory subject to a perfected security interest for equipment. Under section 9-306(3)(a), if the filing office for inventory (original collateral) and equipment (first-level proceeds) is the same, then the secured party need not take any additional steps to keep its security interest in the equipment perfected beyond the ten-day period of automatic perfection. Any person who wished to take a security interest in the equipment would, upon checking the filings, discover the inventory filing. He would then have notice that the equipment might be proceeds of the inventory and could investigate the source of the equipment. Suppose that, instead of making an exchange, the debtor sold inventory for cash (first-level proceeds) and used the cash received from the sale to pay for some equipment (second-level proceeds). As would be the case in a direct exchange, a subsequent lender who wished to use the equipment as original collateral would have notice from the inventory filing that the equipment might be proceeds subject to a perfected security interest. The second lender would have greater difficulty in discovering this fact, however, because he would have to trace the cash received for the inventory to the equipment. To relieve potential lenders of this burden, the Code sponsors added the exception in section 9-306(3)(a), which requires the original secured party to take steps to perfect its security interest in the second-level proceeds when he acquires them with first-level cash proceeds.\textsuperscript{73} It is

\textsuperscript{71} The exclusion of non-negotiable CD's from the file in the same office rule is even more complete than their exclusion from the perfect as to proceeds rule. In the former rule, which turns on filing, there is no room for reading the Code as permitting continued perfection under the common law. \textit{Cf.} note 66 \textit{supra} (meaning of "perfect" in U.C.C \textsect 9-306(3)(c)).

\textsuperscript{72} Proceeds of proceeds are "proceeds," U.C.C. \textsect 9-306(1), and are referred to as "second-level proceeds" in this Article. Proceeds of the original collateral are "first-level proceeds."

\textsuperscript{73} If the original financing statement already on file indicates the type of property constituting the second-level proceeds (e.g., it covers "inventory and equip-
important to note that the additional steps are necessary only when the second-level proceeds are acquired with "cash proceeds." If, instead of selling inventory for cash, the debtor sold it on credit and assigned the account (first-level proceeds) to pay for equipment, then the security interest in the equipment would not become unperfected ten days after receipt; rather, it would remain perfected.

The distinction between "cash proceeds" and "non-cash proceeds," which affects the file in the same office rule of section 9-306(3)(a) and other proceeds rules discussed below, is as follows: "Money, checks, deposit accounts, and the like are 'cash proceeds.'" 74 Negotiable certificates clearly are excluded from the term, "deposit account"; therefore they are "non-cash proceeds." 75 The difficulty is that non-negotiable certificates are not so clearly excluded. If a non-negotiable certificate is treated as a negotiable one and is excluded from the term "deposit account" (and thereby included as potential original collateral under article 9), then it too will be "non-cash proceeds" when received upon the disposition of original collateral. Conversely, if a non-negotiable certificate of deposit is a "deposit account," then it will be "cash proceeds" under section 9-306.

Let us assume that the debtor exchanges inventory subject to a perfected security interest for a certificate of deposit, and that the debtor immediately transfers the certificate to a third party in exchange for equipment. If the certificate were negotiable, and therefore cash proceeds, then (because filings for equipment and inventory are made in the same office) the security interest in the equipment will remain perfected indefinitely. 76 If the certificate in the example were non-negotiable, and considered non-cash proceeds, then the result would be the same. But if the non-negotiable certificate were considered a deposit account and therefore cash proceeds, a security interest in the equipment would become unperfected ten days after receipt of the equipment by the debtor. An additional filing would be necessary to continue perfection beyond the ten-day period, or the original filing would have had to

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74. U.C.C. § 9-306(1).
75. U.C.C. § 9-105(1)(e). See text accompanying note 37 supra. The text following note 81 infra explores the accuracy of this assertion.
76. With certain exceptions not relevant to this Article, a financing statement lapses, and the security interest becomes unperfected, after five years. U.C.C. § 9-403(2). The secured party may continue the effectiveness of the financing statement for successive five-year periods by filing successive continuation statements. U.C.C. § 9-403(3).
refer to "equipment."

Should the Code treat the non-negotiable certificate differently from the negotiable certificate? To a large extent the exception for a second-level proceeds acquired with cash proceeds is arbitrary; a line must be drawn somewhere. When the first-level proceeds are cash or a check, tracing the second-level proceeds through the first-level proceeds to the original collateral arguably is more difficult than when the first-level proceeds are goods. When a negotiable certificate is first-level proceeds, the relative difficulty of tracing is hard to assess. Nevertheless, in that event, the secured party will remain continuously perfected in the second-level proceeds. Whether a certificate received as first-level proceeds is negotiable or not does not affect the difficulty of tracing second-level proceeds to original collateral, so there is no reason to distinguish negotiable from non-negotiable certificates for purposes of the file in the same office rule. On the other hand, by distinguishing negotiable from non-negotiable certificates and treating the latter as cash proceeds, we would not significantly interfere with the operation of that rule. Thus neither aspect of section 9-306(3)(a)—neither the general rule nor the exception for the second-level proceeds acquired with cash proceeds—gives significant guidance on whether to consider a non-negotiable certificate of deposit a "deposit account" and "cash proceeds" and, therefore, excluded from article 9.

4. The Identifiable Cash Proceeds Rule—Section 9-306(3)(b)

We now turn to the final situation in which a security interest in proceeds continues perfected beyond the ten-day period: when a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds. The impact of this rule is best seen in the light of its history. The drafters designed the 1972 proceeds section in part to correct an error in the 1962 Code. The 1962 version of section 9-306(3) seemingly permits a filing as to original collateral to perfect indefinitely a security interest in a negotiable instrument received as proceeds. This re-

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77. See note 73 supra.
78. This assumes that the security interest in the CD does not become unperfected. See text accompanying notes 80-83 infra.
79. See generally note 55 supra.
81. Id. U.C.C. § 9-306(3)(a) provides:
The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless.
(a) a filed financing statement covering the original collateral also covers proceeds . . . .
sult—whereby a security interest in, say, a negotiable certificate of deposit may be perfected by filing—is directly contrary to a basic article 9 rule: possession by the secured party is the only effective way to perfect a security interest in an instrument.\footnote{82} Under the 1972 text, it is clear that if the debtor receives a negotiable certificate as proceeds, then the secured party must take possession of the instrument before the expiration of the ten-day period in order to have a continuously perfected security interest in the certificate.\footnote{83} The Code makes an exception for negotiable instruments that are essentially cash payments, such as checks. So long as these “cash proceeds” are identifiable, perfection continues indefinitely, even if the debtor retains possession.\footnote{84}

What is the reason for distinguishing between a check, as to which a perfected security interest continues indefinitely, and a negotiable certificate of deposit, as to which perfection terminates ten days after the debtor receives the certificate? Presumably the Code draws this distinction because checks and other cash equivalents are rarely used as commercial collateral; therefore, no notice of encumbrances need be available to potential secured creditors. Were a non-negotiable certificate of deposit to be distinguished from a negotiable one (non-cash proceeds) and be treated like a check (cash proceeds), then a secured party who originally had a security interest in, for instance, equipment or farm products would be able to retain a secret security interest in a non-negotiable certificate received as proceeds. This result would contravene a major purpose of article 9 generally and section 9-306(3) specifically: the abolition of secret liens. Unlike the check, the non-negotiable certificate is not a cash equivalent; like the negotiable certificate, its use as commercial collateral is not so uncommon as to justify permitting a secret security interest in it to remain perfected indefinitely.

Moreover, the likelihood of a long-standing, undisclosed security interest in a check is not of great practical concern. A debtor is not likely to hold a check for more than a few days after its receipt. Rather, the debtor will almost invariably deposit the check for collection at the earliest possible time, and the secured

\footnote{82} U.C.C. § 9-306(3)(a) (1962 Official Text).

\footnote{83} U.C.C. § 9-304(1). This rule is subject to possible temporary perfection without possession per U.C.C. §§ 9-304(4), (5), 9-306(2), (3), see note \textit{supra}, but a secured party who lacks possession of an instrument may lose to other claimants, U.C.C. § 9-308 (purchaser who gives new value and takes possession), U.C.C. § 9-309 (holder in due course).

\footnote{84} U.C.C. § 9-306(3)(b).
party rarely will object to its deposit.\textsuperscript{85} In the overwhelming majority of cases, nothing would be served by requiring the secured party to take possession of a proceeds check in order to perfect a security interest in it. On the other hand, a debtor is not likely to transfer a negotiable or non-negotiable certificate of deposit for collection immediately upon receipt. Rather, he is likely to hold it, and other creditors might rely on his possession to their detriment. Thus, by classifying the non-negotiable certificate of deposit as cash proceeds, one paves the way for the creation of statutorily authorized secret interests in personal property. The lack of any commercial justification for such a secret security interest makes it desirable to classify a non-negotiable certificate of deposit as non-cash proceeds, like its negotiable counterpart.

The distinction between a check and a negotiable certificate is not the only distinction arising from the definitions of cash and non-cash proceeds. These definitions also operate to distinguish a debt owed by a bank to its depositor that is represented by a negotiable certificate (non-cash proceeds) from a similar debt that is represented by a passbook (cash proceeds). Understanding the basis for this distinction may clarify the status of the non-negotiable certificate of deposit as either cash or non-cash proceeds. As indicated in the preceding paragraphs, the negotiability of the certificate is significant but not conclusive, inasmuch as certain negotiable instruments are deemed to be cash proceeds. Of greater significance is the fact that an account holder customarily uses his passbook account with some frequency, as he does his checking account. He makes deposits; he withdraws funds. So long as the account holder is able to use it without restriction, the account is virtually worthless as collateral. The secured party may find that, by the time of the debtor's default, the debtor has withdrawn most or all of the account, leaving the secured party in effect unsecured. Conversely, the debtor usually has put his money into a passbook or checking account so that he will be able to withdraw it as necessary; he is likely to object to limitations on his use of the account. As a consequence, for both the debtor and the secured party, an account of this kind is unsuitable as collateral.

An account evidenced by a negotiable certificate of deposit is different. In that case the debtor has placed a single deposit with the issuer. Typically, the debtor does so because he anticipates that he will not withdraw the funds for a fixed period of time. He will be more willing to surrender control over the account to the

\textsuperscript{85} A collecting bank may acquire a security interest in a check claimed as proceeds of a secured party's collateral. The bank's security interest takes priority. U.C.C. § 4-208.
secured party, who, having control, will be more willing to rely on
the certificate as collateral.

The foregoing observations concerning negotiable certificates
apply equally to non-negotiable ones. Unlike a passbook account,
an account evidenced by a non-negotiable certificate of deposit is
not subject to repeated deposits and withdrawals. Because it is
much more useful as original collateral, a non-negotiable certifi-
cate should not be treated like a savings account passbook (cash
proceeds) but rather like a negotiable certificate (non-cash
proceeds).

An important premise of the foregoing discussion is that a
negotiable certificate of deposit is non-cash proceeds. This pre-
mise was derived from two Code provisions: “an account evidenced
by a certificate of deposit” is not a “deposit account,” and a de-
posit account constitutes cash proceeds. We now test the valid-
ity of this premise by examining the negotiable, demand, savings
certificate.

The definition of “cash proceeds” includes “[m]oney, checks,
deposit accounts and the like.” One might argue that a negoti-
able, demand, savings certificate is as liquid as any of the three
specified cash proceeds; that it is, for all practical purposes, a cash
equivalent; and that therefore it should be considered cash
proceeds.

Although somewhat appealing, this argument ultimately is
unpersuasive. If a negotiable demand certificate is cash proceeds,
then a security interest in it may be perfected indefinitely through
filing with respect to the original collateral. It was precisely to
prevent perfection of security interests in negotiable instruments
through filing that the Code sponsors amended the proceeds sec-
tion. Amended section 9-306(3)(b) does provide that a security
interest in certain negotiable instruments (checks) may be per-
ected indefinitely without the secured party’s taking possession.
But, as we discussed above, a check is exceedingly likely to be
deposited within a few days after its receipt. Indeed, not only
does the Code penalize one who holds a check for a long period
without depositing it for collection, but business realities also in-

86. U.C.C. § 9-105(1)(e). See also text accompanying note 37 supra.
89. U.C.C. § 9-306(3). See text accompanying note 74 supra.
90. See text accompanying notes 80-83 supra.
91. Generally, by failing to initiate bank collection of a check within the time
specified in U.C.C. § 3-503, the debtor will discharge any indorser and, in the event
the drawee becomes insolvent during the delay, will discharge the drawer. U.C.C.
§ 3-502(1). In addition, because the drawee bank is under no obligation to its cus-
tomer (the drawer) to pay a check presented more than six months after its date, a
duce prompt collection. The sooner the payee-debtor deposits a check, the sooner the funds underlying it become available to him. 92 Moreover, the longer the payee-debtor holds a check, the greater the possibility that the drawer will use the funds to cover other checks and the drawee bank will dishonor the check for insufficient funds. In this event, the payee-debtor will have a claim only against the drawer, 93 and this claim will be of negligible value if the drawer cannot be found or is judgment-proof.

A negotiable, demand certificate of deposit presents different considerations. As indicated above, delay in collection of a check may render it and the obligation it embodies uncollectible. In contrast, delay in presentment of a demand certificate will not affect the issuing bank's liability to the debtor, except in the rare case of bank insolvency. Nor need the debtor fear that the issuer will pay the certificate to a third party. 94

The negotiable, demand certificate of deposit more closely resembles a demand note than it does a check. Indeed, there are only three differences between a certificate of deposit and a de-

92. See U.C.C. § 4-213(4). The term "funds" is used for convenience. A bank account is a debt owed by the bank to its customer. The customer has a choice in action against the bank—not a claim to specific cash or currency. 10 Am. Jur. 2d Banks § 339 (1963). A check orders the drawee bank to pay the debt to the payee (our debtor). Cf. U.C.C. § 3-104(2)(b) (definition of check). If the check is deposited to the debtor's account, payment of the check gives the debtor a choice in action against his (depositary) bank. See U.C.C. § 4-213(3), (4). The debtor will be able to use that choice by ordering the bank to pay a third party—the payee of the debtor's check.

93. The drawee bank does not incur liability until it accepts the check, pays it, or fails to return it in a timely fashion. U.C.C. §§ 3-409(1), 4-213(1), 4-302. Upon timely dishonor of the check, the drawer will be liable on his underlying obligation to pay the purchase price and on his contract as drawer of the check. U.C.C. §§ 3-802(1)(b), 3-413(2).

94. If the issuer should pay the debt represented by an article 3 certificate to a third party while the debtor had possession of the certificate, the bank's obligation to the debtor would not be discharged. U.C.C. § 3-603(1).
mand note made by a bank. The former contains an acknowledgment of receipt of money;\textsuperscript{95} holders of the former are likely to be protected by federal deposit insurance;\textsuperscript{96} and a cause of action is likely to accrue sooner on the former than on the latter.\textsuperscript{97} The first difference is irrelevant for our purposes; each of the other two suggests that a demand certificate may prove better security for a long-term loan than a bank's demand note.

Is a bank's demand note "cash proceeds"? Demand notes of non-bank makers are not cash proceeds.\textsuperscript{98} Accordingly, a secured party must take possession of such a note within ten days after its debtor receives it as proceeds or its security interest will become unperfected.\textsuperscript{99} The only significant differences between a bank's note and that of a non-bank are the maker's degree of solvency and the likelihood of prompt payment. These differences bear on the desirability of taking these notes as collateral, but they should not affect the perfection requirement. A demand certificate of deposit may be more attractive as collateral than either a bank note\textsuperscript{100} or a non-bank note. Of the three instruments, then, the demand certificate is most properly the object of the policy expressed in section 9-306(3)—the elimination of secret liens. Thus if an ordinary demand note is non-cash proceeds, requiring perfection through possession within ten days, it follows that a demand certificate of deposit is non-cash proceeds as well.

It is possible to challenge the assumption that an ordinary demand note is non-cash proceeds. One might argue that a demand note made by a solvent and honorable maker is "as good as cash." Nevertheless, in the contemporary United States, promissory notes—even bank notes—are not readily transferable in the marketplace as a medium of current payment.\textsuperscript{101} There is no stat-

\textsuperscript{95} U.C.C. § 3-104(2)(c).
\textsuperscript{97} A cause of action against the maker of a demand note accrues upon its date or, if no date is stated, on the date of issue. A cause of action against the issuer of a demand CD does not accrue until demand is made. U.C.C. § 3-122(1), (2). Other than their definitions, this is the only distinction between notes and negotiable CD's in articles 3 and 4.
\textsuperscript{98} See notes 101-02 & accompanying text infra.
\textsuperscript{99} U.C.C. § 9-306(3).
\textsuperscript{100} See notes 96-97 & accompanying text supra.
\textsuperscript{101} In the United States, "[t]he means of payment are paper money issued by the Federal Reserve Banks and the U.S. Treasury, coins issued by the Treasury, and checking accounts in private banks." J. Culbertson, supra note 28, at 116.

The use of an instrument as a medium of current payment explains why a cashier's check, which is legally equivalent to a bank's note, U.C.C. § 3-118(a), is cash proceeds, whereas a demand certificate of deposit is not. One expects the former to be taken in payment and collected quickly by the payee. The latter rarely is used by payment and often is "issued with the understanding that [it] will be held for a considerable length of time." U.C.C. § 3-122 official comment 1.
utory basis on which to distinguish the note of a rich saint from that of an impoverished welcher. Indeed, there is no statutory basis for including any promissory notes as cash proceeds. When the Review Committee revised the definition of cash proceeds, they were fully capable of including demand notes had they so desired. The revised definition of “cash proceeds” does include “deposit accounts,” a term specifically including both the time and demand deposit. But the definition excludes the certificate of deposit without regard to when the certificate is payable. Had the Review Committee wished to distinguish between time and demand certificates, it could have done so easily. Absent a compelling reason to make this distinction, courts should not do so.

5. Proceeds in Insolvency Proceedings—Section 9-306(4)

Secure in our classification of negotiable certificates of deposit as non-cash proceeds, we return to our consideration of non-negotiable certificates. We have seen that a non-negotiable certificate more closely resembles a negotiable certificate than it does any of the specified types of cash proceeds, such as passbook accounts or checks. We have also seen that by classifying a non-negotiable certificate as non-cash proceeds, we significantly reduce the potential for secret, perfected security interests. The distinction between classes of proceeds also is important when insolvency proceedings have been instituted by or against a debtor. Section 9-306(4) stipulates that in that event, the secured party has a perfected security interest only in the proceeds set forth in its four subsections. We now consider the differences that would arise under section 9-306(4) from the treatment of a

102. Cf. U.C.C. § 3-122(1) (cause of action accrues at different time for time instrument than for demand instrument). In a similar vein, one can argue that had it intended to distinguish between negotiable and non-negotiable CD’s, the Committee would have done so, as did the California legislature. CAL. COM. CODE § 9-105(1)(e) (West Supp. 1981) (negotiable CD excluded from “deposit account”). See generally note 121 infra. Although it supports the conclusion of this Article, this argument is not particularly persuasive, given that the addition of the words “other than an account evidenced by a certificate of deposit” to the proposed definition of “deposit account,” CAL. COM. CODE § 9-105(1)(e), was apparently not one of the Committee’s major concerns. See notes 50-54 & accompanying text supra. In contrast, the Committee’s decision not to distinguish between demand and time accounts appears in both PRELIMINARY DRAFT No. 2, note 44 supra, which was the object of extensive scrutiny, and its FINAL REPORT, note 44 supra.

103. U.C.C. § 9-306(4) provides as follows:

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which
non-negotiable certificate of deposit as a deposit account (cash proceeds) rather than as non-cash proceeds.

Under section 9-306(4)(a), a secured party who is perfected as to original collateral has a perfected security interest "in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds." Thus a negotiable certificate of deposit, to the extent it constitutes identifiable proceeds, will be subject to a perfected security interest. A non-negotiable certificate, if treated as non-cash proceeds, will be subject to the same statutory provision. If, however, non-negotiable certificates are distinguished from negotiable ones and are treated as "deposit accounts," then unless the non-negotiable certificate "contains only

is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings; and

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is

(i) subject to any right to set-off; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).


104. See note 103 supra.

105. U.C.C. § 9-306(4)(a), (b), contemplates that cash proceeds may be "identifiable," whether they are kept separate or commingled. Even under the 1962 official text, courts generally rejected the views of Professor Gilmore, 2 G. Gilmore, supra note 103, at 735-36, and permitted a secured party to treat proceeds as "identifiable" to the extent it was able to trace the proceeds into a deposit account, notwithstanding any commingling that may have occurred. See, e.g., Brown & Williamson Tobacco Corp. v. First Nat'l Bank, 504 F.2d 998 (7th Cir. 1974); Universal C.I.T. Credit Corp. v. Farmers Bank, 358 F. Supp. 317 (E.D. Mo. 1973). But see Morrison Steel Co. v. Gurtman, 113 N.J. Super. 474, 481, 274 A.2d 306 (1971) (dictum).
proceeds," it will not be subject to a perfected security interest under subsection (4)(a). Nevertheless, it may be subject, at least in part, to a security interest under subsection (4)(d). By the terms of this subsection, the secured party will have a perfected security interest in all deposit accounts in which proceeds have been com-
mimgled with other funds.\textsuperscript{106} The security interest will not necessarily be in the whole deposit account (certificate); rather, it will be subject to any rights of set-off and limited to an amount set forth in the formula found in section 9-306(4)(d)(ii).\textsuperscript{107}

An example will serve to clarify this. Assume a debtor re-
ceives an $800 check upon the sale of inventory subject to a per-
fected security interest. The debtor then uses this check and an additional $200 of non-proceeds cash to purchase a $1000 time certificate, which the debtor is holding a month later, when he institutes state insolvency proceedings.\textsuperscript{108} What is the secured party's collateral?

If the certificate were negotiable and the secured party is per-
mitted to trace the proceeds check to the certificate, then the sec-
cured party would have a perfected security interest in eighty percent of the certificate as "identifiable non-cash proceeds." This security interest would not be subject to the limitation in section 9-
306(4)(d)(ii) nor, arguably, would it be subject to the issuing bank's right of set-off.\textsuperscript{109} If, however, commingling destroys iden-
tifiability, then the secured party will have no security interest in the certificate.

In the case of a non-negotiable certificate, the secured party's rights turn on whether the certificate is a deposit account. If it is a deposit account, then the rules with respect to negotiable certificates would not apply to it. The secured party would have a se-
curity interest in the entire amount of the certificate (rather than eighty percent), but that interest will be subject to the issuing bank's right of set-off (if any) and to the limitation formula. De-
pending, \textit{inter alia}, on whether a right of set-off exists, on the amount of cash proceeds received by the debtor within the ten

\textsuperscript{106} See note 103 \textit{supra}.

\textsuperscript{107} The formula in subsection (4)(d)(ii) limits the secured party's interest in commingled deposit accounts to the amount of cash proceeds received by the debtor within the 10 days prior to the insolvency proceeding, less the amount of these proceeds paid to the secured party or remaining separate.

\textsuperscript{108} As used in the Code, "[']insolvency proceedings' includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved." U.C.C. § 1-201(22). For a discussion of the history of state insolvency laws, see J. MOORE & W. PHILLIPS, DEBTORS' AND CREDITORS' RIGHTS ch. 4, § 1 (4th ed. 1975).

\textsuperscript{109} For discussion of the right of a bank to set off proceeds contained in the debtor's bank account against a debt owed by the debtor to the bank, see Murray, \textit{supra} note 4, at 454; Skilton, \textit{supra} note 4, at 181-207; Note, \textit{Conflicts}, note 4 \textit{supra}. 
days prior to the institution of the insolvency proceedings, and on the amount of payments made to the secured party on account of these proceeds, the secured party may be completely unperfected, perfected as to the entire certificate, or anywhere in between.

Is there a reason for distinguishing between non-negotiable and negotiable certificates in this context? Subsection (4)(d) deals with the problem that arises when a debtor periodically deposits proceeds and other (non-proceeds) funds into a single bank account and periodically makes withdrawals from the account. The common law permitted the secured creditor to claim only those deposits of proceeds that he could prove the debtor made and did not withdraw.110 Proof of deposits often was difficult because the debtor's records, even if available to the secured party, were often unenlightening. After proving the deposits, in order to determine which funds (proceeds or non-proceeds) were withdrawn, the creditor had to apply common law tracing rules.111 To avoid resorting to these sometimes complicated rules, the drafters of article 9 created section 9-306(4)(d). Under this section, when proceeds have been commingled with other funds in a bank account, the secured party need not prove and trace each deposit in order to claim his security interest. Rather, the secured party need only prove that some proceeds were commingled with other funds. He automatically receives a security interest in the entire deposit account, subject to the limitation formula in subsection (4)(d)(ii). On occasion the subsection will be more favorable to the secured party than the common law rule would have been.112 The drafters assumed, however, that in most cases, an insolvent debtor's entire bank account would constitute proceeds deposited during the several weeks preceding bankruptcy, and that in many cases the secured party might be able to establish his claim to the entire balance on common law theories of tracing.113 By preventing the secured party from tracing all proceeds into a commingled account, and by limiting the perfected security interest in insolvency proceedings to the amount of cash proceeds received by the debtor within the ten days prior to insolvency proceedings, section 9-306(4)(d) is likely to be less favorable—or at least no more

110. See J. White & R. Summers, supra note 103, § 24-6, at 1011-12.
111. Those who have considered the problem apply the "lowest intermediate balance" test to determine the effect of withdrawals from and additions to an account in which proceeds have been commingled with non-proceeds. Universal C.I.T. Credit Corp. v. Farmers Bank, 358 F. Supp. 317, 324-27 (E.D. Mo. 1973); Skilton, supra note 4, at 140-41. See RESTATEMENT (SECOND) OF TRUSTS § 202 comments i, j (1959), for an explanation of the test and related rules.
112. This was assumed to be the case in Arizona Wholesale Supply Co. v. Itale (In re Gibson Products), 543 F.2d 652, 656 (9th Cir. 1976), cert. denied, 430 U.S. 946 (1977).
113. 2 G. Gilmore, supra note 103, at 1340.
favorable—to the secured party than non-Code tracing rules would be in the vast majority of cases.114 This limitation is the price the secured party pays for failing to police his collateral and for being relieved of his common law tracing burdens.

It is arguable, then, that section 9-306(4)(d) should not apply to the certificate of deposit representing commingled funds. Unlike a checking account, which is the subject of frequent deposits and withdrawals, a certificate typically represents a single deposit. The burden on the secured party to identify the sources of the deposit is the same in the case of a non-negotiable certificate as it is in the case of a negotiable one. Because a certificate of deposit always is paid in full or renewed, a secured creditor need not be concerned with matching partial withdrawals to particular deposits.

On the other hand, section 9-306(4)(d) serves to encourage a secured party to police its collateral. As we have seen, section 9-306(3)(b) allows a secured party to retain indefinitely a secret, perfected security interest in cash proceeds.115 In the event of insolvency proceedings, when the interests of unsecured creditors are most at stake, section 9-306(4)(d) may cut back significantly on the effectiveness of this secret security interest. That section induces the secured party to take control of cash proceeds, since failure to do so will result in the secured party’s being unperfected when perfection is needed most. There is no need for subsection (4)(d) in the case of non-cash proceeds. Perfection in non-cash proceeds is automatic for ten days after receipt of the certificate by the debtor, but it is lost thereafter unless the secured party takes or has previously taken steps to give notice to third parties of his claim. The institution of an insolvency proceeding will not affect this result. Thus, regardless of whether a non-negotiable certificate is classified as cash or non-cash proceeds, the proceeds rules encourage the secured party to publicize or assert its interest in the proceeds within ten days after the debtor receives them, lest the interest become unperfected in insolvency proceedings. But, as noted above, the inducement is stronger in the case of non-cash proceeds, because some notice must be given to third parties.

114. Consider the case where 12 days prior to bankruptcy, the debtor receives a $1000 check as proceeds of the collateral and deposits it in a bank account containing non-proceeds. The debtor receives no other proceeds and makes no other deposits or withdrawals from the account. The common law rule would permit the secured party to claim the entire $1000. See J. WHITE & R. SUMMERS, supra note 103, § 24-6, at 1011-12. But U.C.C. § 9-306(4)(d) limits the secured party’s perfected security interest in the commingled account to the amount of cash proceeds received by the debtor within 10 days before the institution of the bankruptcy proceeding, i.e., $0. See U.C.C. § 9-306(4)(d).

115. See text accompanying and following note 84 supra.
within ten days or perfection is lost even when no insolvency proceedings are involved.

The foregoing analysis shows that for proceeds purposes, non-negotiable certificates of deposit function more like negotiable certificates (non-cash proceeds) than like checks and passbook savings accounts (cash proceeds). It is true that the proceeds rules of both subsection (3) and subsection (4) will work effectively regardless of how non-negotiable certificates are classified. But the rules will work better if negotiable and non-negotiable certificates are treated alike, i.e., if a non-negotiable certificate of deposit is not "cash proceeds," does not evidence a "deposit account," and thus may serve as original collateral under article 9.

C. The Exclusion of Deposit Accounts from Article 9—Section 9-104(l)

How does this conclusion square with the purpose of excluding "deposit accounts" from article 9? The Code drafters first excluded bank accounts from the scope of article 9 in section 9-104(j), which appeared in January 1955.116 The sponsoring organizations gave no reason for this exclusion.117 Official comment 7 to section 9-104, which was added to the 1957 official text,118 purports to explain the exclusion of bank accounts from article 9. This comment, which has been retained despite the changes of the 1972 official text,119 explains as follows:

Rights under life insurance and other policies, and deposit ac-

116. Supplement No. 1 to the 1952 Official Draft of The Uniform Commercial Code, § 9-104(j), states that article 9 does not apply "to . . . any deposit account or savings account maintained with any bank, bank and trust company, national banking association, savings bank, building and loan association, savings and loan association, or credit union." AMERICAN LAW INSTITUTE & NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM LAWS, UNIFORM COMMERCIAL CODE: AMENDMENTS TO THE 1952 OFFICIAL DRAFT 61-62 (1955) [hereinafter cited as SUPPLEMENT NO. 1].

117. Subsections (h), (i), and (j), which first appear in SUPPLEMENT NO. 1, note 116 supra, each excluded certain transactions from the application of article 9. The sponsors added these subsections to "make clear that rights represented by a judgment, rights of set-off and certain other transactions are not subject to the Article." Id. at 62.

118. In an attempt to expand and clarify the scope of the exclusion, the sponsors also amended (and renumbered) § 9-104(j) as follows: "This Article does not apply . . . (k) to a transfer in whole or in part of any of the following: . . . any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization." U.C.C. § 9-104(k) (1957 Official Text).

119. Since the 1972 official text, § 9-104(l) has read as follows: "This Article does not apply . . . (l) to a transfer of an interest in any deposit account (subsection (1) of Section 9-105), except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312)." Official comment 7 was changed to reflect the renumbering of the subsection and the fact that a security interest may be taken in a deposit account as proceeds.
counts, are often put up as collateral. Such transactions are quite special, do not fit easily under a general commercial statute and are adequately covered by existing law. Paragraphs (g) and (k) make appropriate exclusions.

This explanation gives little, if any, aid to a determination whether article 9 includes or excludes non-negotiable certificates. The comment suggests that the use of a “deposit account” as collateral is “quite special” but occurs “often.” What makes a checking account special? Legally, it is no more than a debt owed by the bank to its customer, the debtor. As a practical matter, however, the debt not only is payable in whole or in part on demand, but in fact will be paid immediately upon demand. Thus the value of the checking account as collateral prior to default is negligible. The debtor may at any time unilaterally render it nugatory. Moreover, banks are continually receiving deposits to an account and allowing the depositor to draw upon them. As a consequence, the debtor can control the size of the account, which fluctuates with much greater frequency than an ordinary debt taken as collateral.

Although these “special” attributes may explain why demand accounts infrequently serve as collateral in the commercial context, they do not justify the exclusion of all bank deposits from article 9. An account that is evidenced by a negotiable or non-negotiable certificate of deposit, that does not involve a frequently fluctuating debt, and that usually is not payable on demand, lacks the special qualities of a checking or passbook account. It is more like other rights to the payment of money, nearly all of which are subject to article 9.120

As a second reason for section 9-104(f), comment 7 asserts that deposit accounts do not fit easily under a general commercial statute (such as the Code). The accuracy of this assertion is not self-evident. Anyone who has studied article 9 is struck by the fact that the vast majority of problems arising under the article have clear answers. Given the comprehensiveness of article 9 and the multitude of transactions it addresses successfully, the sugges-

120. Article 9 excludes other transactions, but the reasons for these exclusions are clearer. Some relate to transactions removed from commercial financing. U.C.C. § 9-104(f) (accounts transferred for non-financing purposes); U.C.C. § 9-104(h) (judgments); U.C.C. § 9-104(k) (tort claims). Others respect the supremacy of federal law and the sovereignty of states. U.C.C. § 9-104(a) (security interest subject to federal statute); U.C.C. § 9-104(e) (transfer by governmental unit). Still others are relationships outside the scope of article 9 or regulated by other statutes. U.C.C. § 9-104(b), (c) (non-consensual liens); U.C.C. § 9-104(d) (wage assignments); U.C.C. § 9-104(i) (set-offs); U.C.C. § 9-104(j) (interests in real estate). The sponsors apparently excluded insurance policies in U.C.C. § 9-104(g) to placate the insurance industry. See 1G. Gilmore, supra note 103, § 10.7 (discussing the exclusions from the 1962 article 9).
tion that the use of deposit accounts as collateral "does not easily fit" under the Code appears to be without foundation. Surely those who drafted a statute governing the complications arising from after-acquired property and future advances were capable of making the necessary adjustments to cover security interests in bank accounts. But even if the comment were realistic, its reasoning does not apply to certificates of deposit. The difficulty of fitting deposit accounts under a general statute arises primarily from the fluctuating nature of the account and the debtor's control over it. These aspects are not present in the case of a certificate of deposit. To the extent that comment 7 refers to the commercial focus of article 9, one can respond that although a checking or savings account is not likely to serve as commercial collateral, a certificate of deposit is.

The third purported reason for excluding bank accounts from the scope of article 9 is that the law is adequately covered by existing non-Code law. Even if that were the case, which it is not, the suggestion of the official comment flies in the face of section 1-102. A codification of the non-Code law can be expected to simplify and clarify that law, as article 9 has done with respect to other secured transactions that were "adequately covered by existing law." In addition, codification should have the desired effect of making the law uniform among the various states. And if, as Professor Gilmore suggested, courts will look to the Code in fashioning the common law of excluded secured transactions, then direct, rather than indirect, application of the Code would seem preferable.

Indeed, one may infer from section 1-102 a presumption that article 9 be read to include all transactions arguably subject to it, so that potential secured parties may avail themselves of the relative certainty of Code law in their frequent attempts to obtain a security interest that is enforceable against the debtor and third parties. In addition, when a creditor's interest in collateral is an article 9 security interest, the creditor may assess its risks by con-

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121. Apparently without undue confusion or difficulty, California has refused to enact § 9-104(f) of the official text and has instead set forth a method of perfecting a security interest in a bank deposit under its version of article 9. CAL. COM. CODE § 9302(1)(b) (West Supp. 1981).
122. Two of the "underlying purposes and policies" of the Code are "to simplify, clarify and modernize the law governing commercial transactions" and "to make uniform the law among the various jurisdictions." U.C.C. § 1-102(2)(a), (c). The full text of U.C.C. § 1-102(1), (2) is set forth in note 43 supra.
123. U.C.C. § 9-104 official comment 7.
124. 1 G. GILMORE, supra note 103, at 316.
resulting a set of reasonably clear rules that govern its priority with competing claimants of the collateral.\textsuperscript{126} If, however, the creditor takes its interest outside article 9, then its priority may be in considerable doubt.\textsuperscript{127}

In summary, the reasons suggested in official comment 7 for excluding deposit accounts from article 9 are not compelling even when applied to checking accounts.\textsuperscript{128} They are wholly unpersuasive when applied to certificates of deposit—whether negotiable or non-negotiable.

Accordingly, one must search for an unarticulated reason for the exclusion. By far the most common problem with respect to the use of bank accounts as collateral arises when the bank refuses to pay the account to a creditor who has taken the account as col-

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\item[\textsuperscript{126}] See, e.g., U.C.C. § 9-301(1)(b), (2), (4) (lien creditors); U.C.C. §§ 9-307, 9-301(1)(c), (d) (buyers); U.C.C. § 9-312 (competing secured parties); U.C.C. § 9-313 (real estate claimants).
\item[\textsuperscript{127}] See, e.g., Universal C.I.T. Credit Corp. v. Congressional Motors, Inc., 246 Md. 380, 228 A.2d 463 (1967). In that case, the holder of a landlord’s lien for distress for rent and a perfected article 9 secured party both claimed the debtor’s inventory of automobiles. To resolve the dispute, the court examined, on the one hand, the “mixture of rules of the common law, many stemming from feudal times, implementing and supplementing Maryland legislation, and longstanding practice,” which comprised the applicable law of distress, and, on the other hand, the conditional sales statute, which had been repealed. Id. at 382-83, 228 A.2d at 465.
\item[\textsuperscript{128}] Some courts have interpreted § 9-104 to exclude from article 9 only the creation of security interests of the kinds set forth therein and competing priorities of those security interests. See, e.g., Peterson v. Ziegler, 39 Ill. App. 3d 379, 350 N.E.2d 356 (1976). Under this interpretation, article 9 governs priorities between an article 9 security interest and an interest excluded from the article. Id. This approach is of little comfort to a lender who takes a deposit account as collateral outside article 9, since, under § 9-201, a competing article 9 secured party ordinarily will prevail.
\item[\textsuperscript{129}] Professor Phillips reached this conclusion in another context. See Phillips, \textit{Flawed Perfection: From Possession to Filing Under Article 9}, 59 B.U.L. Rev. 1, 47-48 (1979). Professors Coogan, Kripke, and Weiss argued that article 9 should be amended to provide a rule for perfection of security interests in bank deposits as original collateral, thereby eliminating a “difficult priority conflict between a Code claim to a deposit as proceeds and a competing non-Code claim.” Coogan, Kripke & Weiss, \textit{The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements}, 79 Harv. L. Rev. 229, 263 (1965). Professor Kripke was the Associate Reporter of the Article 9 Review Committee, and Professor Coogan was one of the two consultants (with Professor Gilmore), so it is surprising that the Committee retained the deposit account exclusion. Their cryptic conclusion that “the inclusion of bank deposits should not defeat the policies that led to their present exclusion,” suggests that the two men had reservations about abolishing the exclusion. Id. The article does not, however, articulate the basis for these reservations.
\item[\textsuperscript{129}] Professor Hawkland presented a variation on the theme sounded by official comment 7. Referring to loans secured by passbooks, he intimated that inclusion of passbook loans in article 9, would for “no good reason . . . upset procedures that had proved satisfactory.” Hawkland, \textit{The Proposed Amendments to Article 9 of the U.C.C.—Part IV: The Scope of Article 9}, 77 Com. L.J. 79, 83 (1972). Hawkland failed to mention any unique aspects of the procedures, save to inform us that financiers regard them as pledges. Id.
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lateral because the bank claims to have a right of set-off against its customer (the debtor) that is effective against the customer's assignee (the creditor). Banks prize the right of set-off. Concern that courts might subject this right to the attachment and perfection requirements of article 9 led directly to the promulgation of present section 9-104(i), which provides that article 9 does not apply to any right of set-off.129 The same concern for loss of set-off rights may well have motivated the banking industry to persuade the sponsors of the Code to exclude deposit accounts as well.130 In this way, not only would a bank not have to take a security interest in order to exercise a set-off, but also the relative priority of the bank that sets off and the assignee of the account (secured creditor) would be determined by common law rules familiar, and often favorable, to the bank.131

We have seen that the proceeds provisions of article 9 work better when the Code treats a non-negotiable certificate of deposit like its negotiable counterpart, excludes it from the definition of deposit account, and thereby subjects it to article 9. Fundamental Code policies—the need to clarify the law and to make it uniform—support this reading, and the articulated justifications for excluding deposit accounts as original collateral are inappropriate.

129. SUPPLEMENT NO. 1, note 116 supra. Professor Gilmore explained that "[j]anking groups were . . . concerned lest someone, someday, might think that a bank's right of set-off, because it was called a lien, was a security interest." 1 G. GILMORE, supra note 103, at 316. As Gilmore pointed out, however, "a right of set-off is not a security interest and has never been confused with one." Id. at 315.

130. The sponsors first excluded bank accounts from article 9 in the same draft in which they first excluded set-offs. SUPPLEMENT NO. 1, note 116 supra. But see CALIFORNIA BANKERS ASSOCIATION, PROPOSED STATUTE ON SECURED TRANSACTIONS IN PERSONAL PROPERTY §§ 5105, 5304(1)(c) (1958) (bank deposits included as general intangibles, as to which perfection is automatic).

131. If a non-negotiable CD is considered a "deposit account," U.C.C. § 9-105(1)(e), and thus may not stand as original collateral under article 9, then non-Code law will resolve the conflict between the assignee and the issuer who wishes to set off. This will be true even if the certificate is a § 3-805 "non-negotiable instrument." See U.C.C. § 3-306 (rights of holder depend on non-Code law). Reported cases suggest that non-Code law may also apply if the certificate is not a "deposit account" and the assignee is an article 9 secured party. Cf. First Wis. Nat'l Bank v. Midland Nat'l Bank, 76 Wis. 2d 662, 670, 251 N.W.2d 829, 833 (1977) (security interest in negotiable CD); Commercial Discount Corp. v. Milwaukee W. Bank, 61 Wis. 2d 671, 214 N.W.2d 33 (1974) (security interest in checking accounts as proceeds). Other cases suggest that the secured party prevails under article 9. See Citizens Nat'l Bank v. Bornstein, 374 So. 2d 6, 10-12 (Fla. 1979) (right of set-off against non-article 3 CD denied because right not granted by article 9). Cf. Citizens Nat'l Bank v. Mid-States Dev. Co., Ind. App., 380 N.E.2d 1243, 1247 (1978) (perfection security interest in bank account proceeds prevails under U.C.C. § 9-201); Associates Discount Corp. v. Fidelity Union Trust Co., 111 N.J. Super. 353, 358, 268 A.2d 330, 332 (1970) (court assumed perfected secured interest in bank account proceeds prevails under article 9). For further discussion of this priority problem, see authorities cited in note 4 supra. The issuer will be unable to set off against a holder in due course of a negotiable certificate. U.C.C. § 3-305.
One may argue that, nevertheless, the exclusion of deposit accounts from article 9 represents the legislative resolution of competing interests and, as such, is entitled to some weight. This Article does not, however, advocate overruling the legislature and subjecting security interests in all deposit accounts to article 9. Rather, it construes the deposit account exception, in accord with clear, articulated Code policies and concludes that the term, “deposit account,” which excludes “an account evidenced by a certificate of deposit,”\textsuperscript{132} excludes an account evidenced by a non-negotiable certificate.\textsuperscript{133}

III. CLASSIFICATION OF NON-Negotiable CERTIFICATES AS ARTICLE 9 COLLATERAL

A. The Statutory Categories

Having concluded that the proceeds rules and general principles of the Code dictate that non-negotiable certificates not be excluded from article 9, we now consider how article 9 applies to these certificates. Although it applies to all kinds of personal property—tangible and intangible—article 9 occasionally distinguishes among the types of property used as collateral.\textsuperscript{134} Classifying the collateral is crucial to a determination of what a secured party must do to perfect its security interest.\textsuperscript{135} The non-negotiable certificate appears to fit within either of two categories: “instrument” or “general intangibles.”\textsuperscript{136} Inasmuch as “general

\textsuperscript{132} See U.C.C. § 9-105(1)(c), quoted in text accompanying note 37 supra.

\textsuperscript{133} The cases comport with this conclusion. See notes 6-7 supra.

\textsuperscript{134} Classification of collateral under the 1962 official text is discussed in 1 G. Gilmore, supra note 103, ch. 12. The 1972 amendments subsumed “contract rights” under the rubric of “accounts,” thereby eliminating the former as a separate type. U.C.C. § 9-106. The 1977 amendments distinguished between certificated and uncertificated securities. U.C.C. § 9-105(1)(i).

\textsuperscript{135} U.C.C. § 9-303(1) provides in part as follows: “A security interest is perfected when it has attached [pursuant to U.C.C. § 9-203(1)] and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306.” As used in this article, “perfection” refers not to attachment plus any additional step, but rather only to the additional step. In most cases, the additional step (perfection) will be the filing of a financing statement or the secured party’s taking possession of the collateral. See U.C.C. §§ 9-302 (filing), 9-304 (possession), 9-305 (possession).

\textsuperscript{136} U.C.C. § 9-105 provides in relevant part as follows: (1)In this Article unless the context otherwise requires:

(i) “Instrument” means a negotiable instrument (defined in Section 3-104), or a certificated security (defined in Section 8-102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.

U.C.C. § 9-105(i). U.C.C. § 9-106 provides in relevant part as follows: “‘General
intangibles” includes all personal property not falling within the other Code categories, we turn first to a consideration of “instrument” as defined in article 9.

Three types of writings comprise the class of instruments: an article 3 negotiable instrument, an article 8 certificated security, and “any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary endorsement or assignment.” By definition, a non-negotiable certificate of deposit does not contain the elements of negotiability set forth in article 3. Therefore, it may be an “instrument” only if it qualifies as either a “security” or “other writing.”

1. The Article 8 Certificated Security

Section 8-102(1)(a) defines “certificated security,” and at least one court has held that a non-negotiable certificate of deposit fits within that definition. To be sure, a non-negotiable certificate is an obligation of the issuer that is represented by an instru-

intangibles’ means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money.” U.C.C. § 9-106.

137. The writer clearly remembers the genesis of the term ‘general intangibles’ in the Code. It started when Mr. (Peter) Coogan pointed out to a group that had been working on Code problems that there was no catchall term for describing, and no provision setting forth how to perfect assignments of patents, copyrights, rights to literary property, etc., which were not included in the then existing five categories . . . .

Kripke, Suggestions for Clarifying Article 9: Intangibles, Proceeds, and Priorities, 41 N.Y.U. L. Rev. 687, 691 (1966). Professor Gilmore observed that the term “is openended with a vengeance.” 1 G. GILMORE, supra note 103, at 381.

138. For the complete text of U.C.C. § 9-105(1)(i), see note 136 supra.

139. In this Article, unless the context otherwise requires:
   (a) A “certificated security” is . . . an obligation of the issuer which is
   (i) represented by an instrument issued in bearer or registered form;
   (ii) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
   (iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

U.C.C. § 8-102(1)(a).

   See Abraham Lincoln Ins. Co. v. Franklin Sav. & Loan Ass’n, 302 F. Supp. 54, 56-57 (E.D. Mo. 1969) (dictum), aff’d, 434 F.2d 264 (8th Cir. 1970); In re Estate of Fanning, 161 Ind. App. 380, 383 n.1, 315 N.E.2d 718, 720 n.1 (1974) (dictum), aff’d, 263 Ind. 414, 333 N.E.2d 80 (1975). Contra, Jones v. United Sav. & Loan Ass’n, 515 S.W.2d 869, 872-73 (Mo. Ct. App. 1974). All the foregoing cases applied the definition of “security” contained in § 8-102(1)(a) of the 1962 text. The 1977 amendments changed the form, but not the substance, of the definition. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PROPOSED REVISION OF ARTICLE 8 AND RELATED CHANGES IN OTHER ARTICLES RECOMMENDED BY THE PERMANENT EDITO-
COURT OF APPEALS OF NEW JERSEY [1981]

CERTIFICATES OF DEPOSIT

To qualify as an article 8 certificated security, a certificate must be issued in bearer or registered form. Although they often issue negotiable CD's (money market instruments) in bearer form to facilitate sale through brokers, banks rarely, if ever, use bearer form for non-negotiable savings certificates. A non-negotiable certificate may well, however, appear in registered form.

To be a certificated security, a non-negotiable certificate also must be "of a type commonly dealt in on securities markets or commonly recognized in any area in which it is issued or dealt in as a medium of investment." This aspect of the definition is perhaps the least clear. The definition seems to suggest that only instruments for which there is an organized market are article 8 securities. But courts have read the phrase, "of a type," to include instruments, such as stock of a closely-held corporation, for which there is no organized market or, at times, no market at all. In the official comments to the 1977 amendments, the Code sponsors approved this broad reading. The comments also suggest, however, that article 8 should not apply to certain investments that are not commonly traded. Indeed, official comment 2 to section 8-102 explicitly states that "bank checking and savings accounts are intended to be excluded from the definition [of 'uncertificated secur-

Rial Board for the Uniform Commercial Code xvii (1977) [hereinafter cited as Article 8 Report].

141. The 1977 amendments substituted the word "represented" for the word "evidenced," to convey more accurately "the notion that a certificated security is, in many ways, treated as if it were the property itself." Article 8 Report, supra note 140, at 5. The text following note 193 infra supports the view that banks ordinarily treat a non-negotiable CD as if it "represents" the issuer's obligation.

142. For a discussion of money market CD's, see notes 28-30 & accompanying text supra.

143. A certificated security is in "registered form" if

(i) it specifies a person entitled to the security or the rights it represents; and

(ii) its transfer may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security so states.

U.C.C. § 8-102(1)(d). The following legend is typical of a non-negotiable CD issued in registered form: "This certificate is transferable only on the books of this bank, in which event a new certificate of like tenor and amount will be issued to the transferee hereof." Victory Nat'l Bank v. Oklahoma State Bank, 520 F.2d 675, 677 (Okla. 1973). Even if it lacks such a legend, however, a certificate may be in registered form if its transfer may be registered on the books of the bank.


146. U.C.C. § 8-102 official comment 2.
ity," which omits the "commonly recognized . . . as a medium for investment" language, because they are not commonly traded."\textsuperscript{147} On the other hand, the comment implies that checking and savings accounts (presumably including accounts represented by non-negotiable savings certificates) might be included within the definition of certificated security "since those accounts are commonly recognized as media for investment."\textsuperscript{148} Unfortunately, the Code does not define "investment."\textsuperscript{149} One author has suggested that "[i]n its most comprehensive sense, it is generally understood to signify the laying out of money in such manner that it may produce a return in excess of the capital outlay."\textsuperscript{150} Arguably, then, a non-negotiable certificate is a medium for investment. The Supreme Court of Oklahoma has so held;\textsuperscript{151} however, the Missouri Court of Appeals has held the contrary.\textsuperscript{152}

To be an article 8 security, a non-negotiable certificate also must be "one of a class or series or by its terms divisible into a class or series of . . . obligations."\textsuperscript{153} The Oklahoma Supreme Court found that a non-negotiable certificate met this test merely because its issuer numbered the certificates consecutively.\textsuperscript{154} The Missouri Court of Appeals did not agree.\textsuperscript{155}

The purposes underlying article 8 help to resolve whether the "medium for investment" and "class or series" tests should be interpreted to include a non-negotiable certificate. Unlike the federal securities laws, which are primarily anti-fraud, regulatory statutes, the purpose of article 8 is to define the rights and duties

\begin{footnotes}
\begin{enumerate}
\item \textsuperscript{147} \textit{Id.}
\item \textsuperscript{148} \textit{Id.}
\item \textsuperscript{149} One of the questions of policy prepared for a public hearing on article 8 by consultants to the New York Law Revision Commission was, "Does the phrase 'medium for investment' require definition?" \textit{2 Law Revision Commission, State of New York, Report and Record of Hearings on the Uniform Commercial Code for 1954}, at 920 (1954) [hereinafter cited as Commission Report]. The question was barely mentioned at the hearings. \textit{See id.} at 921-1008.
\item \textsuperscript{150} E. \textsc{Guttman}, \textit{supra} note 41, at S.1-23.
\item \textsuperscript{151} Victory Nat'l Bank v. Oklahoma State Bank, 520 P.2d 675, 677 (Okla. 1973). The court's reliance on a statute permitting a guardian to invest his ward's funds in a certificate of deposit, however, is not well placed.
\item \textsuperscript{152} Jones v. United Sav. & Loan Ass'n, 515 S.W.2d 869, 872-73 (Mo. Ct. App. 1974). The court gave no support for this position. The Code does not state if the question whether a certificate is commonly recognized as a medium of investment is one of law or of fact. The concept of "common recognition" suggests that the Code anticipates changes in the type of paper in which people invest and that the use of any given type of paper as an investment vehicle is a question of fact. \textit{See} Kenney v. Porter, 557 S.W.2d 589 (Tex. Civ. App. 1977); U.C.C. \textsection 8-102 official comment 2. \textit{See also} U.C.C. \textsection 1-102(2)(b). But \textit{of}. First Nat'l Bank v. Lone Star Life Ins. Co., 524 S.W.2d 525, 533-34 (Tex. Civ. App.), \textit{writ of error refused}, 529 S.W.2d 67 (Tex. 1975) (non-negotiable CD is article 9 "instrument" as a matter of law).
\item \textsuperscript{153} U.C.C. \textsection 8-102(1)(a)(iii). \textit{See note} 139 \textit{supra}.
\item \textsuperscript{154} 520 P.2d at 677.
\item \textsuperscript{155} 515 S.W.2d at 872-73.
\end{enumerate}
\end{footnotes}
of those who participate in the issuance and transfer of investment securities.\textsuperscript{156} The definition of security is a functional one, which depends on the manner in which a given instrument is treated in the marketplace.\textsuperscript{157}

One key feature of an article 8 security is its negotiability.\textsuperscript{158} Negotiability promotes transfer, because it allows one who purchases a security to do so without the risk that his transferor’s conduct may have prejudiced his rights.\textsuperscript{159} Consistent with this policy, article 8 applies to and makes negotiable an investment, such as stock of a closely-held corporation, that is infrequently traded, but whose transfer, when it does occur, ordinarily presents the same considerations as an open market transfer.\textsuperscript{160} That is, the purchaser normally is a buyer who acquires the stock for investment purposes.\textsuperscript{161} In contrast, one who wishes to invest in a savings account normally does not buy one from an account holder; rather, he takes his money to a bank and opens a new account. When he does transfer his account, an account holder typically does so as a gift. The negotiability afforded by article 8, which protects buyers in an impersonal market transaction, is not appropriate for such a donative transfer.\textsuperscript{162} Similarly, the typical transfer of a non-negotiable certificate of deposit will not be to an investor, but rather to a donee as a gift or to a lender as collateral. Neither type of transfer compels the application of article 8.

To discern the proper scope of article 8, let us consider, as an illustration, a corporation that wishes “to finance the manufacture or marketing of goods or the rendition of services, in relation to a specific transaction or series of transactions.”\textsuperscript{163} The corporation may obtain credit from a single source, to which it may issue its negotiable promissory note. Generally, the payee of the note will hold the note until it matures; however, if the payee wants cash immediately, he will discount the note with a bank.\textsuperscript{164} A note of this kind ordinarily will fall under article 3 and outside article 8.

\begin{enumerate}
  \item See U.C.C. § 8-102 official comment 3.
  \item See U.C.C. § 8-102 official comment 2.
  \item U.C.C. § 8-105(1) makes certificated securities negotiable. \textit{See also} U.C.C. §§ 8-301, 8-302 (dealing with the rights acquired by a bona fide purchaser of an article 8 security).
  \item See U.C.C. §§ 8-301, 8-302.
  \item See notes 145-46 & accompanying text \textit{supra}.
  \item In this article, “purchaser” includes any party that takes an interest in property through a voluntary transaction, including a buyer or a secured party. \textit{Cf.} U.C.C. § 1-201(32) (definition of “purchase”).
  \item \textit{Cf. In re} Estate of Zaharion, 95 Mich. App. 70, 290 N.W.2d 84 (article 8 transfer rules held inapplicable to inter vivos gift of stock), \textit{leave to appeal granted,} 409 Mich. 897 (1980).
  \item E. Guttman, \textit{supra} note 41, at S.1-1.
  \item \textit{Id.} at S.1-2.
\end{enumerate}
because it will run to the order of a named payee. Even if the note were made payable to bearer and were serially numbered, application of article 8 rules would be inappropriate for two reasons. First, the transferee (discounting bank) ordinarily will not rely solely on the credit of the issuing corporation for repayment of its advance. Rather, in the event that the issuer (maker) does not honor its note, the transferee ordinarily will look to its transferor. But unless the parties provide to the contrary, the transferor of an article 8 security does not undertake to pay his transferee if the issuer defaults.\textsuperscript{165} In contrast, article 3 provides that in the typical transaction, the transferor will contract to pay the transferee on the issuer’s default merely by indorsing the instrument.\textsuperscript{166} Second, article 8 reflects the widespread practice of purchasing securities after they have matured or after the issuer has defaulted and, within limits, does not deprive a purchaser who engages in that practice of good faith purchase protection.\textsuperscript{167} Because a corporate note of the kind in question usually is transferred immediately, if at all, no purpose is served by giving good faith protection to a bank that discounts the note after it is due or after the maker has defaulted. Again, article 3 contains a more appropriate rule for the context in which this kind of debt obligation is normally transferred.\textsuperscript{168}

Compare the promissory note described above with a corporate bond or debenture. Rather than representing debt that the issuer has incurred for a specific transaction, the bond and debenture represent debt that is incurred to finance the entire enterprise. In enterprise financing, the corporation typically decides to borrow a fixed amount from any number of sources, each of which receives identical rights, represented by a number of fungible instruments. These rights are set forth not on the instruments themselves, but rather in a separate document. Over time, the original investor may trade his bonds or debentures through markets and exchanges to another investor. The purchaser bases his decision to purchase on the credit of the issuer and the terms of the obligation, not on the credit of the transferor, whom he is unlikely to know. The purchaser chooses a particular obligation of a particular issuer. That obligation may be represented by a large number

\textsuperscript{165} U.C.C. § 8-308(9). \textit{See also} U.C.C. § 8-306 (warranties on transfer).
\textsuperscript{166} U.C.C. § 3-414(1). If the instrument is payable to bearer, the transferor’s indorsement is not necessary for negotiation. U.C.C. § 3-202(1). If the transferee does indorse, however, he makes the contract of indorser and becomes secondarily liable on the instrument. U.C.C. § 3-414(1). He may, however, disclaim this liability by adding to his indorsement words such as “without recourse.” \textit{Id.}
\textsuperscript{167} U.C.C. §§ 8-302, 8-304, 8-305. \textit{See also} U.C.C. § 8-102 official comment 4.
\textsuperscript{168} Under U.C.C. § 3-302(1)(c), a person may not be a holder in due course if he takes the instrument with notice that it is overdue or has been dishonored.
of identical instruments held by a large number of investors; thus the purchaser ordinarily is indifferent as to which instrument in the series he purchases. Accordingly, the lack of transferor liability in article 8 is appropriate; the indorsement liability in article 3 is not. Similarly, because bonds and debentures customarily may be traded after they are due or after the issuer has defaulted, a transferee who purchases under those circumstances should be eligible for good faith purchase treatment. He is eligible under article 8; he would not be eligible under article 3.

It is fair to say, then, that "[a]rticle 3 . . . encompasses isolated transactions . . . whereas article 8 is directed to multiple transactions in which a group of promises, all for the same amount and due at the same time, are made to multiple parties with the intention that the security evidencing their promises will be traded."\(^{169}\) The two types of bank certificates of deposit reflect this distinction. In the case of negotiable, money market CD's a bank's directors decide to offer a fixed number of certificates aggregating a fixed amount.\(^{170}\) The bank may issue a certain number of certificates in each of several denominations, but every certificate of a particular denomination will yield interest at the same rate and will mature at the same time. Once the original issue has been sold, a purchaser may acquire a CD in the organized market. Like the purchaser of a bond, the purchaser of a negotiable CD is concerned with the creditworthiness of the issuer and the terms of the obligation. He is indifferent as to which individual certificate he purchases, as he is to the identity of his transferor.

In contrast, each non-negotiable savings certificate is unique. The issuing bank typically fixes a minimum amount that must be deposited for a fixed period to obtain a particular interest rate, but the amount deposited and the date on which it was deposited will differ from certificate to certificate. The depositor is likely to transfer the certificate, if at all, to a lender or a donee. In these ways, a non-negotiable savings certificate bears a greater resemblance to a corporation's promissory note than to a bond. The fact that the issuing bank may have chosen to identify each certificate with a consecutive number does not affect this resemblance and should not affect the law governing the transfer of the certificate.

We suggested above that, because non-negotiable certificates

\(^{169}\) Jones v. United Sav. & Loan Ass'n, 515 S.W.2d 869, 872-73 (Mo. Ct. App. 1974). The last part of the court's statement is not quite accurate. It is not necessary that the issuer intend that the particular instruments be traded. It is sufficient that that type of instrument might be traded.

\(^{170}\) By controlling the issuance of money market CD's, a bank can affect its liquidity. This method of affecting liquidity is known as "liability management." E. REED, R. COTTER, E. GILL & R. SMITH, COMMERCIAL BANKING 125-29 (1976).
rarely are bought and sold, there is no need for them to be negotiable under article 8. Neither of the other two distinguishing features of an article 8 transfer—that the transferee does not guarantee the issuer's obligation and that good faith purchase protection may be afforded to a purchaser who purchases a stale certificate—compels the application of the article. Indeed, application of article 8 might impose unanticipated liability upon commercially reasonable issuers of non-negotiable certificates. Issuing banks know the difference between negotiable and non-negotiable paper. For any one of a number of reasons, a bank might deliberately issue certificates that are non-negotiable under article 3.171 In doing so, the bank justifiably would expect that any defense to payment that the bank may have against the original obligee (depositor) would be good against his transferee.172 In the absence of any, more substantive, reason to apply article 8 to non-negotiable certificates, holding such certificates to be securities because they are serially numbered serves no commercial purpose and is contrary to the policy of the Code.173

2. The "Other Writings"

In addition to article 8 certificated securities and article 3 ne-

172. See U.C.C. § 3-306.
173. The only reported opinion that has held a non-negotiable CD to be an article 8 security reflects the court's awareness of the effects of negotiability. Victory Nat'l Bank v. Oklahoma State Bank, 520 P.2d 675 (Okla. 1973). In this case, one of Oklahoma State Bank's vice-presidents filled in a blank CD form naming himself as payee, signed the name of another officer, and transferred the certificate to Victory National as collateral for a loan. Realizing that under article 3 Victory National would take subject to the defense of failure of consideration, see U.C.C. § 3-306(b), the court held that Victory was a purchaser of a security who took for value and without notice of the defense and thus took free of Oklahoma State Bank's defense. 520 P.2d at 676-79. See generally U.C.C. §§ 8-202, 8-205. Oklahoma State Bank took the precaution of issuing non-negotiable certificates. In the absence of facts that estop the bank, there is no reason why the issuer should bear the loss.

The consequences of negotiability appear to have affected other decisions as well. Compare Abraham Lincoln Ins. Co. v. Franklin Sav. & Loan Ass'n, 302 F. Supp. 54 (E.D. Mo. 1969), aff'd, 434 F.2d 264 (8th Cir. 1970) (applying Missouri law to hold the issuer of a non-negotiable CD for which it received only partial payment liable for the full amount to an assignee) with Jones v. United Sav. & Loan Ass'n, 515 S.W.2d 869 (Mo. Ct. App. 1974) (applying the same law to hold that the issuer's defense of failure of consideration was good against the creditor-assignee of a non-negotiable CD). In the former case, the losing issuer transferred the certificates on its books to the assignee, 302 F. Supp. at 55, whereas in the latter case the issuer immediately attempted to cancel the certificates and refused to record their transfer, 515 S.W.2d at 870-71. The former case, therefore, may be one of estoppel; however, the losing issuer's misrepresentations to the court may have affected the outcome. 302 F. Supp. at 58.
gallable instruments, "instrument" under article 9 includes certain other writings that meet three requirements: they must evidence a right to the payment of money; they must not be of themselves a security agreement or lease; and they must be of a type which is, in the ordinary course of business, transferred by delivery with any necessary indorsement or assignment.\textsuperscript{174} A non-negotiable certificate will meet the first two tests; it evidences a money claim that is not tied to an interest in goods. The transferability requirement, however, is problematic. The predecessor of this requirement was criticized at the hearings of the New York Law Revision Commission. Its critics raised two issues. First, to whose course of business does the requirement refer? That of the transferee, of the transferor, or of both? That of local business or of business generally throughout the nation? Second, what is a particular "type" of paper? Does the definition preserve the pre-Code distinctions among various kinds of security devices?\textsuperscript{175} The critics were concerned that a court might not concur with a bank's estimate of whether a particular writing taken as collateral is "of a type" that "in ordinary course of business" is transferred by delivery. For example, a bank might conclude that a writing met the definition and therefore would attempt to perfect its security interest by taking possession of the writing.\textsuperscript{176} Were a court to disagree and hold that the writing was not "of a type" that "in ordinary course of business [is] transferred by delivery," the bank, having failed to file a financing statement, would be unperfected.\textsuperscript{177}

Karl Llewellyn saw no problem with either aspect of the definition. The term "in the ordinary course of business" came from the Uniform Trust Receipts Act and had given rise to only two reported cases in its twenty years of existence—a "batting average [that] was mildly high."\textsuperscript{178} As for the "type," Llewellyn responded that "[t]he section has to do with a particular issue, and the particular issue is as to manner of transfer and the 'type' refers to things that are transferred in a particular manner."\textsuperscript{179} It ap-

\textsuperscript{174} U.C.C. § 9-105(1)(i). \textit{See} note 136 \textit{supra}.

\textsuperscript{175} 2 \textit{COMMISSION REPORT, supra} note 149, at 1096 (report of New York Clearing House Association subcommittee on article 9).

\textsuperscript{176} U.C.C. § 9-304(1) (perfection of "instrument" requires possession of the writing).

\textsuperscript{177} U.C.C. § 9-302(1) (perfection of "general intangible" requires the filing of a financing statement).

\textsuperscript{178} 2 \textit{COMMISSION REPORT, supra} note 149, at 1437. The ordinary course of business test is found elsewhere in the Code. \textit{E.g.}, U.C.C. § 9-307(1), (3) (buyers); U.C.C. § 9-308 (purchasers of chattel paper and instruments). Professor Llewellyn was principal draftsman of the Uniform Trust Receipts Act (U.T.R.A.). For a concise history of trust receipts financing under the U.T.R.A. and the common law that preceded it, see 1 G. GILMORE, \textit{supra} note 103, ch. 4.

\textsuperscript{179} 2 \textit{COMMISSION REPORT, supra} note 149, at 1437. The "of a type" language is also found in U.C.C. § 8-102(1)(a), (b), and has given rise to several reported cases.
pears, then, that the transferability requirement, as Llewellyn viewed it, tells us to determine what professionals ordinarily would do to transfer an interest in the claim evidenced by the writing in question. Only if they would deliver the writing (with any necessary indorsement or assignment) will the writing be an article 9 instrument.

Professor Gilmore apparently agrees. He paraphrased the test as follows: "[W]hen ever this method of transfer is recognized in the market as applicable to this writing, then the writing is an 'instrument.'" 180 Unlike Llewellyn, Gilmore acknowledged that there is an element of uncertainty in the "ordinary course of business" test. 181 The test turns on findings as to the current usage of the marketplace. If professionals who deal with a writing attach importance to possession of the writing, then the law likewise should attach significance to possession. 182 However, when commercial practices are in flux, the prevailing usage may be difficult to ascertain and the outcome of the test may be uncertain. This uncertainty is the cost of having the law reflect changes in commercial practices. Gilmore thought this cost would be minimal. He found that in the past, the dividing line between writings transferred by delivery and those transferred by other means had been relatively stable. Although mutations did occur, they were infrequent and rapid, and those writings almost always moved into, rather than out of, the "instrument" category. 183

Assuming relative immutability, Gilmore suggested that the status of the writing at common law will determine whether a writing will be an article 9 instrument. He referred to "instrument" as one of the three "negotiable instrument types" of intangibles: "[T]he claim is represented by some 'indispensable' writing, whose physical delivery is the customary or the only method of transferring the claim and which could under pre-Code law be effectively pledged." 184 By its open-ended definition of "instrument," "article 9 probably broadens the category of intangibles that can be pledged," 185 not only by potentially treating

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See note 145 supra. In 1977, the Code sponsors found it necessary to add a paragraph to the official comments to U.C.C. § 8-102 to amplify what the phrase "of a type" means.

180. 1 G. GILMORE, supra note 103, at 377.
181. Id. at 381.
182. Id. at 379.
183. Id. at 386.
184. Id. at 377. Professor Gilmore used the term "pledge" with respect to intangibles to mean that "possession of some writing by the creditor will give him an interest in the rights represented by it which cannot be defeated by an interest subsequently created by the pledgor." Id. at 12-13.
185. Id. at 390.
new kinds of paper as pledgeable,\textsuperscript{186} but also by reflecting changes in the ordinary manner of transferring claims evidenced by paper of a kind that existed before the Code was drafted. If Gilmore is correct—that paper tends to become pledgeable and, once pledgeable, does not lose this characteristic—then, if a non-negotiable certificate of deposit were pledgeable at common law, it presumably remains pledgeable under article 9.

What was pledgeable under common law?\textsuperscript{187} Clearly pledgeable were those writings that had any quality of negotiability to them. A creditor who took possession of the paper obtained an interest in the rights represented by the paper that could not be defeated by any interest subsequently created by the debtor-pledgor. On the other hand, rights arising under simple contracts were not pledgeable. Professor Gilmore recognized "a vague no-man's land" of what he termed "non-negotiable choses in action—claims evidence by some kind of writing which are thought of as being in some way different from simple contract rights."\textsuperscript{188} A non-negotiable certificate may fall into this category. Gilmore referred specifically to "money instruments which the parties, in some manner which shows that they knew what they were about, have deliberately chosen to make non-negotiable—as by striking words of negotiability or adding a statement that 'this instrument is non-negotiable.'"\textsuperscript{189} Gilmore concluded that for those writings, which would include some typical non-negotiable certificates, "there is no good reason why its delivery should not constitute a pledge if by the formalities of its execution and the like it furnishes its own evidence that the parties looked on it as a serious undertaking."\textsuperscript{190} Although bank certificates of deposit are not particularly impressive documents,\textsuperscript{191} there is no doubt that an issuing bank looks upon the issuance of the certificate as a serious undertaking. Under Gilmore's test, a non-negotiable certificate should have been pledgeable under common law.

In the absence of any persuasive common law cases directly on point,\textsuperscript{192} it is necessary to consider the manner in which a non-

\begin{itemize}
\item \textsuperscript{186} "[T]he decision on pledgeability, with respect to novel kinds of paper, turn[s] on findings as to the current usage of the market place." \textit{Id.}
\item \textsuperscript{187} The following general discussion of pledgeability is based on \textit{Id.} at 16-17.
\item \textsuperscript{188} \textit{Id.} at 16.
\item \textsuperscript{189} \textit{Id.} at 17.
\item \textsuperscript{190} \textit{Id.} (footnote omitted). \textit{Cf.} U.C.C. § 3-805 (article 3 transfer rules apply to certain non-negotiable instruments).
\item \textsuperscript{191} Many contemporary bank CD's are approximately the size of checks and lack seals, ribbons, gilded edges, and other indicia of solemnity.
\item \textsuperscript{192} There is general agreement that a savings account passbook is pledgeable. Walton v. Piqua State Bank, 204 Kan. 741, 754-57, 466 P.2d 316, 327-29 (1970); R. Brown, \textit{The Law of Personal Property} § 8.3 (3d ed. 1975); 4 A. Corbin, \textit{Corbin on Contracts} § 902 (1951); \textit{Restatement of Security} § 1 comment c (1941).
\end{itemize}
negotiable certificate is transferred in the marketplace. Typically, when a bank accepts a non-negotiable certificate as collateral, it takes physical possession of the certificate, together with a written assignment of the certificate to the bank for collateral purposes. Often, the debtor also indorses the certificate. Because people tend to borrow from banks with which they have an established relationship, in many cases the bank will take as collateral a certificate that it itself has issued. In these cases the bank will make appropriate entries in its bookkeeping system to reflect the fact that the claim of its customer to the funds represented by the certificate is encumbered. If it did not issue the certificate, the secured party will notify the issuer in writing of its security interest. A prudent bank (secured party) also verifies the fact that the debtor is the sole claimant to the certificate by obtaining the issuer’s signed acknowledgement that the debtor has a 100 percent undivided interest in the certificate and in the obligation it evidences; that his interest has not previously been assigned or encumbered, voluntarily or involuntarily; and that the issuer will not assert a right of set-off to the detriment of the secured party. By giving notice and obtaining the issuer’s acknowledgment, the secured party seeks to insure not only that its interest has not been impaired by some previous event, but also that its interest will not become impaired in the future—by a subsequent assignment by the debtor, by an attempted set-off by the issuer, or by garnishment by a third party. The secured party also asks the issuer to acknowledge that, when the certificate matures, the issuer will pay the secured party and not the debtor.

193. The following discussion of the manner in which a non-negotiable CD is transferred comes from conversations and correspondence with several individuals who generously shared their knowledge with me and who represent the following banks: Amalgamated Trust & Savings Bank, Chicago; Citibank, N.A., New York; Continental Illinois National Bank, Chicago; Detroit Bank & Trust Co., Detroit; Manufacturers National Bank, Detroit; National Bank of Detroit, Detroit. The generalizations in the text do not necessarily reflect current practices at all of the named institutions. The procedure for taking a security interest in a savings account, described in Security Pac. Nat’l Bank v. First Fed. Sav. & Loan Ass’n, 478 F. Supp. 909 (N.D. Ill. 1980), is nearly identical to the procedure described in the text for a CD.

194. By taking a security interest in a CD that it has issued, a bank takes a security interest in an obligation that it owes the debtor. Thus the bank takes a security interest in the debtor’s property (a chose in action) and not in its own property (money). The relationship, if any, between a security interest of this kind and a right of set-off is beyond the scope of this Article.

195. Proper notification of the issuer is important to the secured party regardless of how the code classifies the non-negotiable certificate of deposit. If, as this Article concludes, a non-negotiable CD is an article 9 instrument, then, under U.C.C. § 9-502(1), “When so agreed and in any event on default the secured party is entitled to notify . . . the obligor on [the] instrument to make payment to him . . . .” If a non-
will follow the foregoing procedure, because it believes that by doing so it has protected its security interest and, that, upon default by the debtor, it will be able to collect the proceeds of the certificate from the issuer quickly and easily. Of primary importance for our present purposes is the fact that bankers typically do take possession of a non-negotiable certificate when accepting it as collateral. In article 9 terms, the writing is in the ordinary course of business transferred by delivery with any necessary indorsement or assignment. It is an article 9 “instrument”; it is not a “general intangible.”

B. Consequences of Classification

Significant practical consequences flow from the classification of article 9 collateral. If the consequences are commercially undesirable, then section 1-102 directs us to reconsider the classification.\(^{196}\)

1. Effect on Current Practices

The most significant effect of classifying a non-negotiable certificate as an instrument is on the manner in which a security interest in the certificate can be perfected. Generally, a security interest in an instrument can be perfected only by the secured party’s taking possession; filing a financing statement is wholly ineffective.\(^{197}\) In contrast, one can perfect a security interest in general intangibles only by filing; the secured party’s taking possession is wholly ineffective.\(^{198}\) A bank ordinarily takes all reasonable steps to perfect its security interest. Notwithstanding its ability to distinguish between a negotiable and non-negotiable certificate, a bank treats each in the same manner: it takes possession of the certificate and notifies the issuer of its interest. Once a bank (secured party) has taken possession of the certificate, subsequent potential secured parties will be on notice that the certificate may be encumbered. These subsequent parties will ask the debtor to produce the certificate, and he will be unable to do so. By tak-

\(^{196}\) See note 43 \textit{supra} for the text of U.C.C. \S 1-102(1), (2).

\(^{197}\) U.C.C. \S 9-304(1), \textit{quoted in note 69 supra}.

\(^{198}\) \textit{Compare} U.C.C. \S 9-302(1) \textit{with U.C.C.} \S 9-305. To the extent that a chose in action, such as a bank’s obligation to repay deposits, is not reified, “possession” of it makes no sense.
ing possession, the secured party satisfies the purpose of the perfection requirement—public notice.\(^{199}\) By classifying a non-negotiable certificate as an article 9 instrument and requiring possession for perfection, the Code protects the reasonable expectations of professionals.\(^{200}\) Unless there is some general principle that favors filing over possession as a means of perfection—even when secured parties typically take possession—classification of a non-negotiable certificate as an instrument makes good commercial sense.

2. Relative Merits of Filing and Possession

In recent years, several authors have perceived a decline in the importance of possession in secured financing and have advocated that perfection of security interests through filing replace—or at least in every case be an available alternative to—perfection through possession.\(^{201}\) We now consider whether the reasons advanced for favoring filing over possession outweigh the arguments previously advanced in this Article for classifying a non-negotiable certificate of deposit as an instrument, thereby requiring perfection through possession and rendering filing nugatory. In making this analysis, it is important to recognize that we are faced with the Code as it now stands. If a non-negotiable certificate may serve as article 9 collateral, then only one method of perfection—either filing or possession, but not both—will be effective. Whatever merit there may be in revising the Code to allow for perfection through filing for instruments, this solution is not available for present-day secured parties.\(^{202}\)

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199. The “real purposes” of the perfection requirements of article 9, U.C.C. §§ 9-302 to 9-306, are “to specify when public notice of the creation of a security interest is required and to set out (indirectly) an appropriate method of giving that public notice.” Coogan, Article 9—An Agenda for the Next Decade, 87 YALE L.J. 1012, 1032 (1978).

200. The protection of justified expectations is one of the primary aims of commercial law. R. Speidel, R. Summers & J. White, Commercial and Consumer Law 4-5 (3d ed. 1981).

201. E.g., Coogan, note 199 supra; McDonnell, A Reevaluation of Public Notice Under Article 9 of the Uniform Commercial Code, in 1A P. Coogan, W. Hogan, & D. Vagts, Secured Transactions Under the Uniform Commercial Code ch. 6C (1980); Phillips, supra note 128, at 209. Although the summary statement in the text is sufficiently accurate for our present purposes, it does, of course, greatly simplify the detailed, sometimes divergent views of the three authors. While expressing no opinion on the relative merits of possession and filing as means of perfection, one author has concluded that in a wide array of commercial contexts, “possession rules serve reasonable expectations and efficiency.” Dolan, The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods, 56 TEX. L. REV. 1147, 1193 (1978).

202. Indeed, the problems caused by the present mutual exclusivity of perfection methods for article 9 instruments and general intangibles are themselves strong arguments for allowing security interests in each to be perfected in the same way. Simi-
Perhaps the strongest argument for preferring perfection through filing to perfection through possession is the belief that the former generally affords better public notice of the security interest to potential purchasers from the debtor. After all, public notice is the primary reason that, in most cases, the secured party must take the additional step of perfection in order to prevail over third party claimants to the collateral. What constitutes adequate public notice has changed over time. Historically, possession of a chattel implied ownership. By taking possession of a chattel as collateral, a secured party gave public notice that it

larly, the fact that a given claim may, intermittently, become reified (represented by an instrument) and "dereified" (general intangible), supports a change in article 9's basic structure. Coogan, supra note 199, at 1036-45. The Review Committee was unwilling to make this change even for instruments received as proceeds of collateral covered by a filing. See notes 80-83 & accompanying text supra. This unwillingness was consistent with the views of the Committee's Associate Reporter, Homer Kripke, and not with the approach later advanced by one of the Committee's Consultants, Peter Coogan. Compare Kripke, supra note 137, at 709, 709 n.35 with Coogan, supra note 199, at 1043-53.

203. Many scholars share this belief. See note 201 supra.

204. See Coogan, supra note 199, at 1032.

[A] security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . . ;

(b) value has been given; and

(c) the debtor has rights in the collateral.

U.C.C. § 9-203(1).

"Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors." U.C.C. § 9-201.

U.C.C. § 9-301(1) significantly cuts back on the broad protection afforded by U.C.C. § 9-201. The former section provides that, subject to an exception for certain purchase money security interests, U.C.C. § 9-301(2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9-312;

(b) a person who becomes a lien creditor before the security interest is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

U.C.C. § 9-301(1).

The few situations in which no additional step is required for perfection are set forth in U.C.C. § 9-302(1)(b)-(e), (g).

205. For a discussion of the possessory security device at common law (pledge), see 1 G. GILMORE, supra note 103, ch. 1.
had an interest, and that the debtor lacked a complete interest, in the collateral.\footnote{206} Once the debtor was divested of the collateral, any subsequent potential purchaser of collateral\footnote{207} who undertook a prudent investigation would necessarily realize that the debtor might not own the property free and clear. He would then be able to make an informed decision whether to buy or lend.

Eventually, the law grew to accommodate non-possessory security interests in personal property. These interests became necessary to facilitate lending secured by property that the debtor could use more efficiently (such as inventory), and by property that by its very nature could not be "possessed" by anyone (such as accounts).\footnote{208} Filing was among the pre-Code methods for giving public notice of certain non-possessory security interests.\footnote{209} The Code has adopted filing as the only method of perfection for certain types of collateral; for most other types, filing is an alternative to possession.\footnote{210}

Many have argued that the debtor's physical possession of particular property no longer significantly affects decisions to extend credit.\footnote{211} Rather, potential creditors rely on the debtor's general financial standing. The way in which most parties learn of the debtor's financial history, his assets, and any encumbrances (including security interests) thereon is through written evidence such as the debtor's financial statement, cash-flow analyses and records, and credit bureau reports.\footnote{212} These writings on which potential creditors rely—particularly those prepared by parties other than the debtor—are more likely to contain accurate information concerning the state of the debtor's assets if that information is available in the public record than if it must be ascertained through visual inspection and cataloguing of the debtor's property.\footnote{213}

To what extent does this argument apply to notice of a security interest in a non-negotiable certificate of deposit? Regardless of the value of collateral that secures a loan, a lender would be

\footnotesize{206. Thus the pledge also deprived the debtor-pledgor of his ability to use or dispose of the collateral to the detriment of the secured party. Dolan, \textit{supra} note 201, at 1163.}

\footnotesize{207. \textit{See} note 161 \textit{supra}.}

\footnotesize{208. The best single source for the development of personal property security transactions over the last century is, of course, I G. Gilmore, \textit{supra} note 103, chs. 1-8.}

\footnotesize{209. \textit{See generally id.} at 462-63.}

\footnotesize{210. One must file to perfect a security interest in accounts and general intangibles. U.C.C. § 9-302(1) official comment 5. With some exceptions, one may, but need not, file to perfect a security interest in goods, chattel paper, and negotiable documents of title. U.C.C. §§ 9-302(1), 9-304(1).}

\footnotesize{211. \textit{E.g.}, Coogan, \textit{supra} note 199, at 1036.}

\footnotesize{212. Phillips, \textit{supra} note 128, at 35, 35 n.135.}

\footnotesize{213. \textit{See id.} at 34-41.
foolhardy to extend credit to a debtor who fails to meet its credit standards. In determining whether a debtor meets these standards, a potential secured party may well rely on financial statements and credit bureau reports. Even if the debtor proves to be creditworthy, a lender may insist on some security for its advance. A lender who takes a certificate of deposit as collateral relies on a single, specific claim of the debtor against a bank in a fixed amount. The lender (secured party) will take steps to insure that the collateral is not dissipated by the debtor. To this end, regardless of any need to perfect its security interest, a secured party will almost invariably take possession of a negotiable certificate. Otherwise, the debtor might negotiate the certificate to a holder in due course, who will take free of the secured party's claim, or might obtain payment of the certificate and spend or abscond with the cash. In either case, by leaving the debtor in possession of a negotiable certificate, the secured party risks the loss of its collateral.

Because a certificate of deposit is so liquid, and because the rules of negotiability give such strong protection to good faith purchasers (holders in due course) of a negotiable certificate, a secured party would be remiss if it relied on the representations of the debtor, his accountant, or a credit bureau as to the continued existence and lack of negotiability of a certificate. Rather, a prudent secured party will require the debtor to come forward with the certificate. If it proves to be negotiable, a secured party will take possession of it.

In many cases, even if the certificate of deposit is non-negotiable, possession will be necessary to protect the secured party. In the case of a section 3-805 "non-negotiable instrument," the issuer will discharge its liability on the certificate and on the underlying obligation it represents by paying the holder, even though the issuer knows of the claim of another. By taking possession of the certificate, a secured party will prevent any other party from

214. U.C.C. § 3-305(1).
215. See U.C.C. § 3-603(1).
216. See notes 15-16 & accompanying text supra.
217. U.C.C. § 3-603(1) provides, with exceptions for stolen instruments and those bearing restrictive indorsements, as follows:

The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim of another person to the instrument unless prior to such payment or satisfaction the person making the claim either supplies indemnity deemed adequate by the party seeking the discharge or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties.

U.C.C. § 3-802(1)(b) provides that where an instrument is taken for an underlying obligation, discharge of the obligor on the instrument also discharges him on the obligation.
becoming a holder and receiving payment that will discharge the issuer and leave the secured party unsecured.

A secured party is likely to take possession even of a non-article 3 CD. Because of the risks of leaving a negotiable or section 3-805 certificate of deposit in the debtor's hands, a prudent secured party will demand to see for itself whether a given certificate falls into either of the two categories. The secured party will also determine thereby that the certificate exists and that it will be able to meet any conditions precedent to payment by the issuer. Having the certificate in its possession, a cautious secured party is unlikely to return it to the debtor, who ordinarily will have no need for it.\(^{218}\)

Thus, given the existing Code rules on negotiability, a secured party can be expected to take possession of every certificate of deposit in which it claims a security interest. In many cases, the requirement of perfection through possession strengthens the inducement to take possession. If a debtor is unable to produce a certificate, a potential secured party has reason to be skeptical about its continued existence and the debtor's ownership of it and has reason to refuse credit thereon. Although the debtor's lack of possession does not necessarily mean that the certificate is subject to a security interest, it is sufficient to put a potential secured party on notice that the debtor may not own the putative collateral free and clear. Similarly, other purchasers of the certificate will be on notice that something is awry when the debtor-seller refuses to turn over the certificate.

It appears, then, that the basic premise of this criticism of perfection through possession—that a potential creditor does not rely on the debtor's possession of particular assets but rather relies on his general creditworthiness—is not completely true in the case of a lender who wishes to take a certificate of deposit as collateral. Even as staunch an opponent of perfection through possession as Professor Phillips seems to have recognized this. He argued that filing is preferable to possession because collateral is more efficiently used when retained by the debtor.\(^{219}\) He recognized, however, that "[t]he parties would, most likely, agree to secured party possession when the debtor cannot use the collateral productively," and that secured party "possession might be considered necessary or desirable to prevent the sale of collateral... without the secured party's consent" to one who would take free of the

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218. A loan officer usually is responsible for making sure a loan is properly secured. Even if he is cognizant of the distinctions among various kinds of certificates of deposit, he is not likely to risk the loss of collateral by exercising his judgment as to the category into which a given certificate falls.

security interest. Both of the circumstances that prompt possession are likely to be present in the case of a certificate of deposit. The lender secured by a certificate is unlike an inventory lender, who hopes the debtor will sell the collateral and use the proceeds to reduce the loan. Rather, the former lender wants to be sure that no one will have a superior claim to the obligation evidenced by the certificate. Such a lender is most unlikely to accept the risk that the debtor will dispose of the collateral, inasmuch as the proceeds will be difficult to trace. An equipment lender has little chance of being repaid if the debtor is unable to use the collateral in his business, and so will prefer to perfect through filing. In contrast, the obligation represented by a certificate is not likely to be necessary to the continued operation of the debtor's business. The debtor who needs cash usually has the option of collecting the certificate, rather than using it as collateral for a loan. By doing the latter, the debtor has determined that the most productive use of the certificate is as collateral in the secured party's control. Admittedly, a problem may arise if the debtor reduces his loan balance to an amount considerably less than the amount of the certificate. In those circumstances, the debtor may wish to use his equity in the certificate as collateral for an additional loan, and the secured party may not object. Unless the original secured party is willing to advance additional credit, the debtor may have difficulty using his equity, because a second secured party cannot also perfect its security interest by taking physical possession of the certificate. The problem of multiple pledges is not the necessary result of possessory security interests. It is the consequence of a lack of clarity in article 9 and is solvable by the parties.

We have seen that, insofar as purchasers of the collateral are concerned, possession of a non-negotiable certificate of deposit by the secured party is likely to provide better notice than would filing. But what of unsecured creditors? These creditors may make an initial determination to extend credit based on financial

220. Id. at 44 n.171. The omitted words refer to buyers in ordinary course.
221. One reason that a lender may prefer to take a CD as collateral is that there is no need to police the collateral, as there is with inventory, accounts, and, to a lesser degree, equipment.
223. The parties are free to agree, for example, that one holds the certificate both on its own behalf and as agent of the other. In the absence of explicit agreement, the second secured party may be able to perfect by giving notice of its interest to the secured party that has possession of the certificate. Cf. U.C.C. § 9-305 (collateral held by a bailee). Professor McDonnell thinks U.C.C. § 9-305 applicable to secondary pledges of instruments. McDonnell, supra note 201, § 6C.08[1][b]. Another solution is for the second lender to repay the debt to the original secured party and be subrogated to the latter's security interest to the extent of the payment. Cf. Kaplan v. Walker, 164 N.J. Super. 150, 395 A.2d 897 (1978) (security interest in certificated motor vehicle).
statements of the debtor or credit bureau reports. How are they to learn of a change in the debtor’s financial situation if the change (certificate used as collateral) is not reflected in the public record?

In general, creditors determine the likelihood of prompt payment in large part on the debtor’s past payment history. Indeed, once a creditor extends credit to a debtor, the creditor most likely will continue to do so, so long as that particular creditor receives payments at a satisfactory rate. Many changes in the debtor’s financial statements or credit reports, such as the grant of a security interest, may go unnoticed—or, if noticed, may be ignored—by a creditor who is being paid. Only a foolish unsecured creditor relies on the fact that particular assets of the debtor are unencumbered at any particular time. The debtor is always free to encumber them or sell them and dispose of the proceeds. If a creditor is serious about relying on particular assets being available upon the debtor’s default, then he should take a security interest in those assets prior to extending credit. If the asset is a non-negotiable certificate of deposit, then the potential lender will seek possession of the certificate. If the debtor is unable to produce the certificate, the lender will learn of possible security interests in it.

224. When a debtor sells the major part of his inventory, U.C.C. article 6 may afford limited protection to unsecured creditors.

225. Professor McDonnell posited a lender who makes unsecured loans on the basis of the debtor’s financial statements, which show great wealth based on stock ownership. McDonnell, supra note 201, at 6C-135, 6C-136. A pledge of the stock certificates, he argued, would not come to the attention of the unsecured lender, whereas a filing (if effective) presumably would be spotted by a credit bureau. Id. To the extent that the unsecured creditor relies on the debtor’s own financial statements, however, both filing and possession are likely to be irrelevant. To protect himself, the creditor may require that the statement be certified. The fact that a debt for credit extended in reliance upon a false financial statement may be nondischargeable in bankruptcy, 11 U.S.C. § 523(a)(2)(B) (Supp. IV 1980), also may induce the debtor to issue an accurate statement. It is largely, in Professor McDonnell’s words, “[t]o the extent that a creditor relies on credit bureaus or other ‘credit assessors’ to tell him of a debtor’s original credit standing or of any unfavorable change in that standing, [that] perfection based on change in physical control of the asset [is] of questionable value.” McDonnell, supra note 201, at 6C-136. How often reliance of this kind occurs is an unanswered empirical question. My personal experience and that of others suggests that unsecured creditors are more concerned with payment history than with the state of title to the debtor’s assets. In any event, there is always a delay between the creation of a security interest in (or sale of) an instrument and notification to potential creditors of the transfer.

The debtor is free to sell stock or give it away. In either case, absent a fraudulent conveyance, the stock will be out of the reach of an unsecured creditor who “relied” on it in extending credit. In either case, the law does not require public notice of the transfer. If the debtor should sell the stock or grant a security interest in it, usually he will receive in exchange value that can be used to pay his unsecured debts. The risk of asset disposition inheres in unsecured lending; no sensible unsecured lender actually relies on the continuing availability of particular assets. If he is truly concerned that a particular asset of the debtor be available, a lender will take a security interest in it.
Cognizant of the problems that may arise from perfection through possession, we now consider whether perfection through filing would be an improvement. It cannot be denied that filing would have its benefits. Filing would facilitate the debtor's use of the collateral for cash to be used in his business. Credit bureaus presumably would discover the filing and report it to their customers, including potential secured parties. In the absence of empirical data, the importance of this fact is not clear. The discussion above suggests, however, that in the case of certificates of deposit, the importance may be slight.

The fact is that professional lenders do take possession of certificates of deposit used as collateral. They do not file. To require filing under the present system would have the effect of rendering unperfected a multitude of security interests that secured parties reasonably believe to be perfected. In addition, it would increase the costs of secured lending. Moreover, potential creditors are aware that security interests in claims evidenced by certain writings may not be reflected in the public record. If they are concerned that these security interests may exist, creditors are free to make further inquiry of the debtor.

As we have seen, most secured parties, regardless of article 9's perfection requirements, would take possession of a certificate of deposit in order to prevent others from obtaining superior rights to the collateral. This Article has suggested some reasons why a potential creditor is unlikely to be misled by this procedure.

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226. One of these problems is determining what constitutes "possession." The problem has arisen in the context of a certificate placed in escrow, e.g., Stein v. Rand Constr. Co., 400 F. Supp. 944 (S.D.N.Y. 1975), and in the context of multiple security interests in the same certificate. See notes 222-23 & accompanying text supra. A related problem is the "taking" requirement of U.C.C. § 9-305. Phillips, supra note 128, at 8-34, discusses these problems in detail.

227. The only reported instance of filing a financing statement to cover a non-negotiable CD is in Washington Commercial Bank v. Bollwerk, 582 S.W.2d 695, 700 (Mo. Ct. App. 1979), where the Mark Twain Bank also took possession of the certificate. Without discussion, the court held the CD to be an instrument and stated (incorrectly) that either possession or filing was sufficient to perfect the bank's security interest. Id.

228. Secured creditors would have to obtain and file a financing statement.

229. Indeed, Professor Phillips himself made this point with respect to banks' security interests in instruments owned by individual debtors. He argued that reliance by other creditors on financial statements reflecting these assets may be too rare to impose the costs of filing in all transactions. "For those creditors who want to rely on net worth but not bargain for and take possession of collateral as security for their credit, it does not seem unreasonably burdensome for them to force the debtor to produce for investigation his claimed assets . . . ." Phillips, supra note 128, at 254. In the larger context, Phillips wrote that "where secured party possession is likely, where confusion is unlikely and where third parties will not mistakenly rely on factors other than possession, there is no reason to require the added cost of filing." Id. at 44 n.171.
Under the existing article 9 scheme, a security interest in a non-negotiable certificate must be perfected either through possession or through filing. The same reasoning that led Professor Phillips to consider “allow[ing] commercial behavior to follow commercial custom” in cases of the individual debtor\(^{230}\) leads to the conclusion that in all cases perfection through possession, although not necessarily ideal, is the preferred method of perfecting a security interest in a non-negotiable certificate of deposit.

**Conclusion**

The 1972 amendments to article 9 solved many problems that arose or might have arisen under the 1962 official text, including several problems in the proceeds rules. As part of the process of amending article 9, the Code sponsors distinguished “an account evidenced by a certificate of deposit” from other bank accounts, which are excluded from article 9.\(^{231}\) The term “certificate of deposit” in article 9 is ambiguous; it may or may not include the non-negotiable certificate. Consequently, the rights of a party that takes a non-negotiable certificate as collateral are uncertain.

This Article argues that courts should resolve the ambiguity and uncertainty by interpreting “certificate of deposit” to include the non-negotiable certificate and thereby subject the non-negotiable certificate to article 9. That interpretation not only furthers the probable intentions of the Code drafters, but also provides a clear, accessible, and efficient set of rules to guide secured parties. Although one might wish to amend the Code’s definition of “deposit account” or add a definition of “certificate of deposit” to reflect that interpretation,\(^{232}\) an amendment is unnecessary. By tracing the effects of different interpretations on the operation of Code rules and on the conduct of parties who use the non-negotiable certificate of deposit, this Article provides courts with the principled basis necessary to support the desired interpretation.

Courts that subject the non-negotiable certificate of deposit to

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\(^{230}\) *Id.* at 254.

\(^{231}\) U.C.C. § 9-105(1)(e).

\(^{232}\) California excludes only the negotiable CD from its definition of “deposit account.” *Cal. Com. Code* § 9105(1)(e) (West Supp. 1981). That CD clearly is an instrument, perfected through possession. *See id.* § 9105(1)(i). The non-negotiable CD is a deposit account. As such, in California only, it is subject to the Code and is perfected by giving written notice to the issuer, or, if the secured party issued the certificate, when the security agreement is executed. *Id.* §§ 9104, 9302(1)(b). It is unclear whether “negotiable certificates of deposit” in California’s § 9105(1)(e) includes the article 8 security. *See U.C.C.* § 8-105. Given the practice of both taking possession and notifying the issuer, this lack of clarity is unlikely to have any practical consequences. The California scheme may be preferable to that of the official text, in which one arguable means of perfection is filing, which virtually no professional ever does.
article 9 often must classify the certificate as either an article 9 “instrument” or a “general intangible.” The distinction between these two types of article 9 collateral usually is clear; in the case of the non-negotiable certificate of deposit it is not. Perhaps the best way to achieve greater clarity within the existing Code framework would be for the Code sponsors to promulgate a special Code provision governing the classification of the non-negotiable certificate.233 They are unlikely to do so. In the absence of an amendment, courts should construe the Code so as to satisfy the justifiable expectations of the parties. By examining the manner in which parties use the non-negotiable certificate of deposit as collateral, this Article demonstrates that courts should classify the non-negotiable certificate as an article 9 “instrument” and thereby require the secured party to take possession of the certificate in order to perfect a security interest in it.

233. Classification of collateral may be important for purposes in addition to perfection. See generally 1 G. Gilmore, supra note 103, § 12.6. Thus, although California specifies the manner of perfecting a security interest in a non-negotiable CD, see note 232 supra, the California Commercial Code provides no more guidance as to the appropriate classification of the non-negotiable CD than the official U.C.C. text.